Part 5

Central Banking in Asia

11 Interpreting the evolution of the monetary regime in Russia

The political economy of rent seeking and central banking

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Introduction

The specificities of the economic development in post-Soviet Russia have long been in the focus of attention of researchers who have united around the assertion that reforms in Russia have been unsuccessful and have not led to the development of a modern and efficient economy (see, e.g., Yakovlev 2014). The country's resource dependency is a central structural problem (Inozemtsev 2018). Much less attention has been devoted to the place of the monetary regime (MR) and the monetary policy (MP) in the political and economic dynamics of the post-Soviet system processes (Johnson 2018; Tompson 1998).[1] It is true that the MP has been the subject of analysis especially its macroeconomic and technical aspects (see, e.g., Esanov et al. [2005] or Korhonen and Nuutilainen [2016]).

The formation and evolution of the MP have reflected the struggle of economic and power interests as well as of the balance of forces of the leading economic and political actors as regards the use and reproduction of the rent resources. The clash of interests has been accompanied by the struggle of ideas, ideology of the main actors as regards the place and role of money and the MP. To the interests and ideas, we could add an institutional momentum, specific dependence on the initial conditions and path dependence related to the moneyless and planned economy. All these factors, together with geopolitical considerations, have determined the MR for the last 30 years. We refer to the analysis of these processes as "the political economy of the MR."[2]

The political economy of the exchange rate regime is of importance within the frameworks of the political economy of the MR. Exchange rate is the link, the anchor binding the national economy with the global economy. It is noteworthy that two main features distinguish the Russian economy from the other emerging markets: (i) it inherited a 70-year-old planned economy, and (ii) subsequently, it was the result of an extremely rapid and unjust formation of a new capitalist class (in the years of President B. Yeltsin).

In this study we propose a theoretical approach which is the result of the studies of other researchers as well as of our personal observations and

discussions with Russian and foreign economists. First, we offer a simplified working succinct model explaining the development of the MR as a function of the dynamics and structure of the main rent resources. In a nutshell, the nature and size of the rent determine the type of sources of money and the type of MR respectively (part two). Second, by using the proposed model and hypotheses we have reconstructed the MR development in Russia for the last 30 years (1990–2020) (part three). Three periods have been differentiated by financial, economic and political crises and instability. These are namely (i) the period up to 1998 – "an inflationary monetary regime," (ii) the 1999–2013 period – "a controlled exchange rate regime" divided into two sub-periods, and (iii) the post 2013 period – when it was proceeded overtly or covertly towards the liberalization of the ruble exchange rate and a switchover towards "inflation targeting (IT)" was declared.

Here we must make an important clarification. The ideas and statements set forth as well as the empirical illustrations reflect our standpoint of external observers of Russia's economic development. To this effect they are marked by the limitations and characteristics of the foreigner's viewpoint. This standpoint is also important for the theory and practice as is the viewpoint of a Russian observer and participant in the events.

The monetary regime and the rent reproduction: definitions, theoretical model, main hypotheses

We shall need a few preliminary working definitions before we proceed to the theoretical model.

Under *a monetary institution*, we shall understand the set of rules and the mechanisms for enforcing them that determine the monetary behavior of economic actors. The system of monetary institutions shall be referred to as a monetary system. When the rules are formal, we shall refer to them as Monetary regime (MR). Apart from the MR there are also informal rules and practices within the framework of the monetary system. In general, they have a national, cultural character and at certain times they are of major significance (e.g., the barter in the late 1990s in Russia, see Yakovlev [2000, 2001]). The new MR could be borrowed from outside or could be domestically constructed. They could also be the result of the formalization of informal practices. And vice versa it is possible to "deformalize" several rules and institutions related to monetary behavior. Such deformalization was characteristic of the self-organizing adaptation of economic agents and the population in the years of state disintegration between 1993 and 1995 (Radaev 2001). In the past in the countries of Eastern Europe and certainly in Russia, to the transfer of institutions from Western Europe was referred to as "forms without substance."

The MR (formal institutions) is above all related to the mechanisms of money supply and in part to the money demand processes (the motives of using money). The MR consists of two large components: external and internal. The

external component is related mostly to the exchange rate regime. The internal component is related to the regime of the interest rate, credit and inflation (the relationship of money with the domestic assets, commodities and services). The first component shows the external sources of money supply while the second – the domestic ones (the two sources are interrelated).

The *Central bank* (CB) is a leading monetary organization, a collective monetary agent. Its main task is the creation, formalizing and enforcing of monetary rules, of formal monetary institutions, that is, the MR and the MP. The other players in the monetary and power field possess varying organizing capabilities and therefore varying opportunities to influence the overall dynamics. The least organized, dependent and losing actor among them is the population (households). Although unorganized the population is an important actor. This is so not only because it votes at elections but also because in the event of a lack of ~~losses~~ compensation the population has the destructive power of social riots and could provoke uncontrollable political turmoil.

We must add a definition for the rent.[3] The rent represents a non-competitive source of material and non-material resources and incomes. The rent includes various elements such as (i) the material, tangible resources (leading resources in Russia are oil and gas which are exported) as well as (ii) non-material resources (intangible) – positioning within the network of power.

There is a consensus among Russian economists as regards the natural rent and its damaging effect for the long-term development of Russia[4] (e.g., Gaidar 2007, pp. 81–130; Inozemtsev 2018, ch. 3). Noteworthy is the second, intangible component of the rent. It includes the power, political and bureaucratic resources (their positioning within the party and the state network). The source of the power resource is of key importance for Russia in the long term. According to V. Inozemtsev:

> The reason is probably the rent character of our economy. . . . It is actually a matter of the entire domestic economy inherited by Russia from the Soviet Union. Privatization which started in the mid-1990s was carried out either without compensation or for symbolic money according to market rates. . . . That is why investments in new projects is often considered risky. . . . Moreover, as a result of this the state power has become the most profitable kind of business in Russia and its ideology has turned out to be the continuous redistribution of available profits.
>
> (Inozemtsev 2018, ~~pp. 189–190~~)

With a view to a theoretical simplification further on we shall refer to two groups of rents – "a natural resource rent" and "a power resource rent" and to respectively two types of MR – (i) for "an externally oriented MR" where the external sources of money supply dominate and in this case the main anchor is the exchange rate, and (ii) for "an internally oriented MR" where the domestic sources of money creation play the leading role and the intermediate and final objectives such as "volume of loans," "interest rate," "inflation," and so forth

determine the MP. As a rule, a fixed exchange rate is applied for the former regime, while a floating exchange rate is applied for the latter regime.

The main theoretical hypotheses can be reduced to the following cause and effect relations and dependencies. First, in a rent economy, the type of MR is the result of the struggle of the leading groups concerned as regards the reproduction of the rent. The MR is an institutional compromise and a temporary balance reflecting the interests of the leading elites and groups and coalitions among them. The classifications of these groups and coalitions can be different – creditors/debtors, external/domestic, industry/finance, and so forth. To put it differently – the type and size of the rent determines the type of the MR. For its part the latter creates conditions for the reproduction of the rent, it serves for coordinating the behavior of the key actors as regards the rent, and so forth. The relations could be illustrated in a simplified form (Figure 11.1):

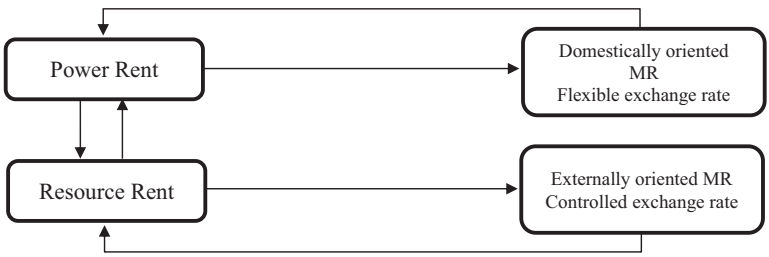

Figure 11.1 Rents and monetary regimes

When we refer to the circular dynamics illustrated in Figure 11.1, we must consider the entire institutional system of the economy where the MR is the structuring but not the only element. Apart from the MR the character of the balance of payments, public finances, labor market, corporate governance to mention but a few are also important.

Second, the dynamics of the MR reflects the changes in the size and nature of the rent, of the coherence of the different types of rent. It can be assumed that an internally oriented MR develops and is even hyperbolized in the presence of a power resource rent. Then it is advantageous for elites and leading groups to develop domestic sources for the creation of money and a floating rate is preferred. The floating rate (and possible exchange restrictions and capital control) makes it possible to reduce and even to put an end of the dependence on foreign countries. Conversely, when the sources of the rent are natural (export of resources), the elites strive to stabilize their relations with foreign countries. A controlled and fixed rate is the best way to create such a stability and predictability. It should be noted that the export of resources is not flexible because of the nature of international resource markets. It is influenced slightly by the manipulations of the rate, especially by its depreciation (Polterovich & Popov 2016). Moreover, the attraction of capital requires a stable or at least predictable exchange rate.

Finally, a third statement about the dynamics of the MR. The transition from one MR configuration to another occurs after an economic, financial or political crisis, when the source of the rent decreases or is exhausted and a new source is sought to replace it. The rent elite is generally preserved although there are redistributions within its frameworks (e.g., in the case of Russia – from oligarchs to government officials, Yakovlev 2006; Robinson 2013). The losers must be compensated in the transition to new MR and MP. Of particular importance to this effect are households (Nenovsky & Rizopoulos 2003). The new MR, which can also be regarded as a new equilibrium within the frameworks of a social game, reflects the new disposition of forces, which makes it possible to mobilize a new rent resource. This resource is reproduced until the emergence of another crisis, and so forth. The crises themselves are provoked by endogenous or exogenous shocks on the size and nature of the rent.

Armed with the aforementioned theoretical model it is possible to reconstruct the development of the MR in Russia for the last 30 years. We must reiterate that what we are proposing is only one of the possible political and economic interpretations.

The evolution of the rent and monetary regime in Russia during the 1990–2020 period

The evolution of post-Soviet Russia and its periodization have been well described in the literature and there is a consensus as regards their main characteristics. There is also a consensus as regards the endogenous logic in the economic and political system of contemporary Russia.[5] The periods follow logically one after the other – they are a manifestation of the life cycle of the system (e.g., Furman 2010; Kapeliushnikov 2016). There is a similar understanding as regards the MR and MP stages (Golovnin 2016; Gurvich 2016).

In general, the periods are reduced to three and two sub-periods defined within the frameworks of the second period (Table 11.1). The first period (1990–1998) covered the unprecedentedly rapid formation of capitalism and the core structures of the market economy. The power resource rent had a leading role during that period, and it was above all related to privatization. There was no established system of property rights during that period. The emergence of the new owners and the reproduction of the power resource rent happened through the credit emission and an inflationary MR. The financial and public debt crisis followed in August 1998.

The power resource rent shrank during the second period (1999–2013); it was internally restructured by being replaced by the rent related to the extraction and export of natural resources. Oil prices rose. The MR serving that process was externally oriented, that is, towards stability and exchange rate control. The sources of the money base and money supply were predominantly external. There were two sub-periods (1999–2008 and 2009–2013) within that period the dividing line of which was a function of reducing the sources of the natural resource rent and of some global and geopolitical shocks (global financial crisis of 2008).

Table 11.1 Periodization of Russian monetary regimes

	MR I	*MR II*		*MR III*
Period	1990/91–1998	1999 – September 2013		September 2013 – ongoing
		1999–2008	2009–2013	
MR orientation	Domestically oriented	Externally oriented		Domestically oriented
MR	Elements of credit and monetary targeting	Exchange rate targeting		Inflation targeting
Exchange rate regime	Various until mid-1993 – Ruble zone (common currency area) 1995–1998 – Exchange rate band	Managed floating Since 1999 – managed floating Since 2005 – dual-currency basket (USD and Euro) Increasing weight of the euro in the basket and since Feb 2007–0,55 USD and 0,45 Euro Floating operation Since Jan 2009 – fixed upper and lower borders of 41 and 26 Rub Since Feb 2009 – floating band at 2 Rub Since Oct 2010 – abandonment of the fixed band		Free floating July 2012–August 2014 – widening of the operational band (at 7 Rub and later 9 Rub) Nov 2014 – cancelling of the operational band and introduction of free floating
Crises	Difficult economic situation with different IMF lending agreements (1992 – SBA, 1993 – STF, 1994 – STF, 1995 – SBA, 1996 – EFF, 1998 – different)	1998 – financial crisis 1999 – SBA approval by the IMF	2008–2009 – global financial crisis	2014–2015 – currency crisis
MP	Growth in CB credit to government GKO Until mid-1992 multiple currency rate 1991–1992 – creation of commercial banks	Bank reserve requirements regulation (differentiated for rouble and foreign currency since Nov 2009)	Currency interventions Repo operations	Inflation targeting framework Interest rate corridor with the main elements – the key rate, standing facilities and Repo operations
CB governors	1990–92 – G. Matiukhin 1992–94 – V. Gerashchenko 1994–95 – T. Paramonova (acting chairperson) Nov 1995 – A. Khandruyev (acting chairperson) 1995–1998 – S. Dubinin	1998–2002 – V. Gerashchenko 2002–2013 – S. Ignatiev		Since 2013 – E. Nabiullina

Source: Authors' collection

The third period which is currently ongoing started after September 2013. Then the natural resource rent was increasingly depleted and oil prices dropped. The elites were forced to search for new sources within the state network, that is, again in the power resource rent. This resource rent was proceeded to MR and MP directed to domestic goals and anchors. The country was isolated, the currency reserves were safeguarded, and the exchange rate was liberalized.

The power resource rent, privatization, floating exchange rate and money emission (1990–1998)

That period was marked by the creation of private owners through privatization. The state property was privatized in lack of domestic savings, capital and in absence of market mechanisms and established property rights.[6] It is important to make a detour here.

It has often been underscored that not only in the former USSR but in CEE as well it is a matter of processes that can be defined as "primitive accumulation of capital" (Nenovsky & Mihaylova-Borisova 2015). In fact, that was not actually the case. R. Simonyan (2016) was right to mention that we could not refer to the PAC (the way Marx interpreted it) – it was rather a matter of looting and giving away property and capital. To this effect P. J. Proudhon with his "Property is Theft" was much more accurate than Marx in the conditions of Russia. As G. Matiukhin, the first governor of the CB, noted that the PAC in the European countries in the 19th century was carried out not only for a long time but also in the conditions of deflation and shrinkage of the money supply (the price of cold rose) (Matiukhin 2017 [1993], p. 75). Savers and creditors dominated at the time. Inversely, in contemporary Russia (during 1992–1995/96 period) things were different. It was not a matter of accumulation of capital or of investments, but a matter of looting rather than of privatization where debtors and thieves predominated (Bunich 2006).[7]

In general participants in the privatization were related to the old party nomenclature who converted their power positions (power resource rent) into property and assets. As noted by numerous Russian observers however that freshly emerging private property being rent property by birth remained dependent, unstable as a status and was inefficiently used. A new rent bank and business elite[8] emerged which consisted of different types of oligarchs. That elite destroyed the state as an independent economic entity and as an institution creating and controlling impartially the rules of the game. The economic and political discourse of the elite was showy liberal and market one. The rent elite considered that independent civil servants and politicians would be a threat for them. The Russian state was practically falling apart, and its fiscal base disappeared. Public finances were in a disastrous state; in 1991 the deficit reached 31% of GDP (in 1994 it dropped to 10%). The only sources for money were external aid and the IMF and the World Bank tranches (see Camdessus 2014; Aleksashenko 1999).

Within the frameworks of that configuration which was unique as regards its scope and complexity the MR and the CB played a key role. That money was unimportant during socialism, the CB was subordinated to planning[9] and MP was non-existent (see Lavigne [1970]). The USSR disintegrated in December 1991 and a little later the monetary space of the Soviet ruble followed suit (the new Russian money was issued in July 1993, for details see Abdelal 2003). After a brief "war" between Gosbank of the USSR and the newly established Russian CB (in December 1990) a fresh tension occurred that time between the Russian CB and the power and political elites. The bank tried to develop an independent and conservative MP,[10] that is, to restrict the unsecured refinancing of the budget and banks. That encountered the fierce resistance of the main political authorities – the coalition composed by the Government, the Duma (Parliament) and the President's staff.[11] That coalition fought for the "unconditional and automatic" printing of money whenever the state institutions and enterprises needed funds. Actually they controlled that "automatic money emission" and channeled the money flows for serving their personal and corporate interests.[12] The automatic emission did not encounter any resistance (even from the liberal Y. Gaidar) thereby resulting in the consensus on the need of an inflationary MP.[13]

The attacks on the attempts at achieving the CB autonomy were extremely aggressive. In July 1992 the CB management was replaced and the old Soviet functionary Viktor Gerashchenko was appointed (since July 1992 acting chairperson/since November 1992 chairman). Gerashchenko cemented the inflationary MR in the country. Any request for refinancing from the budget (see Table 11.2) or from the banks was automatically granted. The money emission was carried out at a gigantic pace.

The inflationary MR reproducing the power resource rent was manifested not only in the large volumes of refinancing but also through the negative real interest rates. According to G. Matiukhin:

> The fact is that it was impossible to stabilize Russia's monetary system with a negative interest rate as a result of high inflation rates. The CB therefore began to raise that rate gradually: initially by 6% to 20%, then by

Table 11.2 Financing the budget deficit in 1993–1995

	1993		*1994*		*1995*	
	Trill of Rub	*%*	*Trill of Rub*	*%*	*Trill of Rub*	*%*
Budget deficit	16,7	100,0	60,5	100,0	73,2	100,0
CB credit	9,9	59,3	48,1	79,5	0	0
Domestic loans	0,2	1,2	6,9	11,4	50,1	68,4
Foreign loans	1,5	9,0	5,5	9,1	23,1	31,6
other	5,1	10,5	0	0	0	0

Source: Illarionov & Sachs 1995, p. 91, tab. 9

> 20% to 40%, then by 40% to 80%. After the second increase Hasbulatov (authors: Chairman of Parliament, Duma) called me on the phone and ordered that our decision be immediately cancelled. I disobeyed. After the third increase, he sent a letter to the CB requesting that the interest rate be kept at its previous level. I disobeyed again. Then Hasbulatov in a traditionally Bolshevik manner forbade me to go abroad: "He will run away somewhere!"
>
> (Matiukhin 2017 [1993], p. 69)

In R. Simonian's words:

> Thus, for instance in February 1993 a commercial bank with good connections could be granted a loan for 7% per month by the CB. The index of consumer commodities' prices rose by 25% during the same month. The result was – a net profit of 15% for a few weeks.
>
> (Simonyan 2016, p. 71)

The issue of money continued to grow at a gigantic pace practically throughout the entire period (the famous statement by V. Gerashchenko that "the large-scale emission of money inevitably leads to a greater economic growth").[14] The velocity of money also rose. According to estimates from December 1992 to April 1994, the velocity of money more than doubled – from 5.4 to 11.4 (Illarionov & Sachs 1995, p. 47). Statistical studies showed that inflation had a strong correlation with the emission of money – in 1992 the correlation occurred with a lag of 4 months, in 1993–5 months, in 1994–6 months, and in 1995 it reached 8 months (see also Sachs [1994], p. 72). And because of the close link between the dynamics of money supply and the budget deficit, inflation moves in line with the development of the deficit and the state of public finances (see Sachs [1994], p. 87). According to another participant in the events:

> The whole growth of the money supply and consequently the level of inflation are today determined by the sums received by the government from the Central Bank.
>
> (Aleksashenko 1999, p. 18)[15]

Along with inflation (the initial leap came from the liberalization of prices on 2 January 1992 when 90% of retail prices and 80% of wholesale prices were liberalized), a strong depreciation of the ruble rate occurred. The volatility of the course reached its peak on October 11, 1994 when the depreciation to the dollar reached more than 20%, and the ruble price quickly rose[16] only a few days after that. V. Gerashchenko was immediately replaced but the existing MR continued to triumph up to the crisis in August 1998.[17] In a nutshell, the elites needed an inflationary MR.

A new factor, the emission of short-term state bonds (GKO) emerged at the end of the period. They were aimed at restricting the direct unsecured

refinancing on the part of the CB, that is, the emission of money. The GKO were launched in 1993 in negligible quantities but gradually increased and reached 3 times per month[18] in 1995. The short-term debt of GKO helped the state cover its current expenses and pay the wages in the public sector. But its short-term character and avalanche-like growth resulted in grave impediments in its servicing. The greater part of that debt consisted of quarterly securities and the attempts at 6 and 12-month emissions failed. The CB often bought GKO on the primary market which ran contrary to market principles. Eventually GKO became a "debt pyramid" used for the enrichment of definite groups. The instability of the GKO was the result of the fact that between 30 and 50% of the GKO volumes were possessed by non-residents who not only speculated but also later withdrew their capital converting it into dollars.

In principle that debt implied a MR based on a predictable exchange rate especially the part of the debt held by non-residents and denominated in dollars (the latter was around 1/3 of the total). As it has already been indicated (unsuccessful) attempts at switching over to the anchor of the exchange rate were made in 1995 when the financing of the budget from the GKO reached 68.4% (11.4% in 1994 and 1.2% in 1993). It is noteworthy that during that same 1995 the banks were also offered a system of loans-for-shares-auctions aimed at "winning" their participation in the purchase of GKO. In a state of a huge economic and financial chaos and of political turmoil towards the end of the period the economic agents and the population spontaneously began to organize themselves and to resort to the use of informal barter and monetary practices and rules.[19]

Summing it up, we may underscore the following. During the first period the MR (until 1999) was a unity of two processes – on the one hand, it was a continuation of the practices, institutions and ideas that existed in the planned economy. On the other hand, the MR reflected the processes of appropriation of the power resource rent in building the new capitalist system. As an example, the easy and automatic crediting was both a technical result of the old institutions of planned economy as well as deliberately sought after because it served the interests and enrichment of leading groups and elites (related to the Duma, the Government, the President's group and the newly established banks).[20] Two groups (business elites and political elites) could be differentiated within the power elites related to the power resource rent. The first aimed at privatization because the political power was temporary for it – until it acquired the business. The second sought long-term power positions in the state apparatus guaranteeing a long-term power resource rent.

To a certain extent that corresponds to the classification of M. Olson of the availability of "roving" bandits and "stationary" bandits, Olson (2000). The second group gradually became emancipated from the first and at a certain point it began to control business. Political power became emancipated from the economic one. A. Yakovlev (2006) referred to a transition from "state capture" to "business capture," R. Simonyan (2016) referred to a transition from "oligarchic capitalism to clerical capitalism" (p. 234), and Gaidar and Chubais (2011) referred to dilemma "oligarchs or the state" (p. 93).

The regular end point of the dynamics thus set forth was the depletion of the power resource rent and the inflationary MR servicing it. The crisis and the default in August 1998 were the concrete result. At the same time inflation contributed to clearing the accumulated debts of the new elites and prepared the ground for the second stage.

Growing resource rent and the regime of a controlled exchange rate (1999–2013)

After the financial crisis and the political instability related to electing President B. Yeltsin's successor it was relatively quickly and logically proceeded to the second economic and political stage (Furman 2010). The main task was to safeguard the achievements of the elites in the first stage, the legitimacy of their property (overcoming the "property without legitimacy"[21] problem). The state had to recover by partially compensating the losing actors – above all the population and citizens (which were a dangerous "revolutionary force"). The depletion of the power resource rent related to privatization was almost automatically replaced by another important and traditional source for Russia – oil and gas exports (the main representatives of the natural resource rent). Russia's researchers had long since defined that rent as the main reason for the lack of economic modernization and for the reproduction of the political authoritarianism. According to V. Inozemtsev:

> Whenever Russia returned to the new turnabout in its history to the commodity specialization the traditional authoritarian state was revived. . . . In this "non-economy" the source of money were not natural resources created by the people. . .; the main objectives of their utilization were to enrich the ruling class as well as to ensure apathy and relative satisfaction (stability) of the masses.
>
> (Inozemtsev 2018, pp. 128, 140)

Since 2000 the natural resource rent recovered, and Russia returned to its long-term economic trajectory. The increase of production and of the export of oil products as well as the rapid rise of their prices on the international markets contributed to that effect. The MR had to adjust to the new conditions; it changed radically and focused on the balance of payments. The exchange rate became the main anchor of the MP, the link with the global economy.

As we have already pointed out within the frameworks of that period two sub-periods can be differentiated. They will be dwelt upon later.

Growing natural resource rent and a stable exchange rate (1999–2008)

The period from 1999 until the onset of the global crisis in 2008 was defined as "*exuberant decade*" (*tuchnoe desyatiletye*) (Simonyan 2016, p. 170). The crisis led to the restructuring of the composition of the leading elite in which the

civil servants and the new political power (V. Putin) rapidly gained the upper hand. The state was restored, the so-called "vertical of power." That occurred relatively fast – after some resistance the oligarchs gave up part of their positions to the state administration (the famous clash for "Yukos" in 2007). According to many observers during that period and particularly up to 2004, there were relatively stable property rights and the rules of the game were respected (Aleksashenko 1999, pp. 21, 57).

Economic reforms started with a fiscal reform and above all with the introduction of a flat tax, low income taxes, and so forth. After the three-fold depreciation of the ruble during the crisis it began to stabilize. Foreign exchange reserves were accumulated partially due to the Law on the forced sale to the state of 75% of exporters' foreign currency revenues. At the same time oil prices rose (the 20-dollar for barrel limit was crossed in 1999 and on 5 July 2008 it reached 144 dollars, see Figure 11.2). The ruble rate became increasingly stable (Polterovich & Popov 2016, p. 194). All that led to the rapid imposition of new, externally orientated MR and MP. The exchange rate became the main anchor. In the years that followed the oil and gas rent grew at accelerated rates and the current account became the major source for money supply in Russia. Capital inflows were also significant. The foreign currency reserves of the CB and the net external assets of the banking system grew. The capital inflow was also significant. The foreign exchange reserves of the CB and the net foreign assets of the banking system grew.[22]

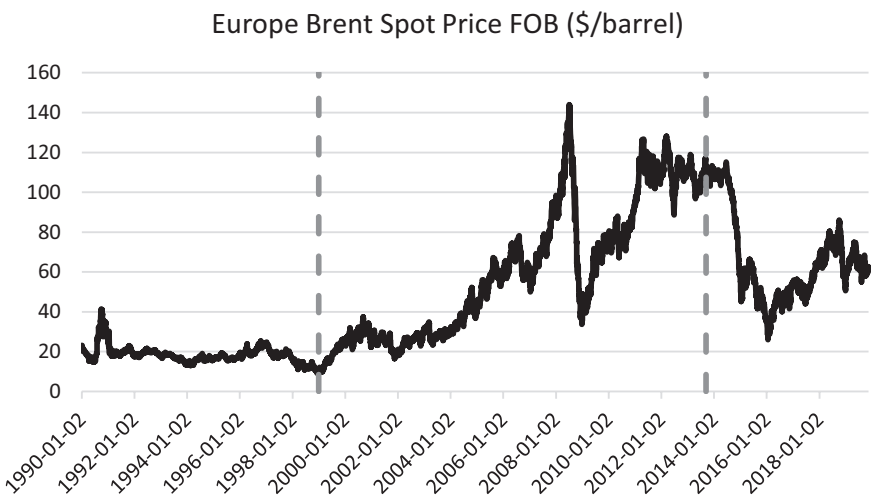

Figure 11.2 Oil price development

Note: The vertical lines represent the beginning of a new MR period.

Source: *EIA – U.S: Energy Information Administration, Europe* Brent Spot Price FOB, viewed 14 November 2019, www.eia.gov/dnav/pet/hist/RBRTED.htm

Still while the stable rate was advantageous for the reproduction of the oil, gas rent and its lobby, it held back the development of other sectors.[23] According to Polterovich and Popov:

> During the 2000s, the export of non-commodity goods became increasingly less profitable. Accumulating reserves, the CB prevented the rise of the nominal rate which from 1999 to September 2014 fluctuated within the 25% range. However, our prices rose 4.5 times since the end of 2013 while prices in the US and the euro zone increased by only 2–3% annually and rose about 1.5-fold during that period. So, the actual rate of the ruble more than doubled.
>
> (Polterovich & Popov 2016, p. 194)

Part of the natural resource rent was mobilized by the state by redirecting it to the public sector. Wages were increased significantly. Armaments were modernized which increased the military expenditure thereof after 2000. Eventually a certain amount was set aside in the newly established Stabilization Fund and the National Welfare Fund.[24] In general, the losers in the previous MR were partially compensated.

Let us dwell on the technical steps undertaken by the CB for the enforcement of the new MR. Those steps were formally set forth in a document of CB.[25] Thus, until 2005 the CB had set an interval for intervention as regards the ruble/dollar rate (Figure 11.3). Since 2005, it proceeded to the operational goal "the value in rubles per basket of dollar and euro." The interventions were

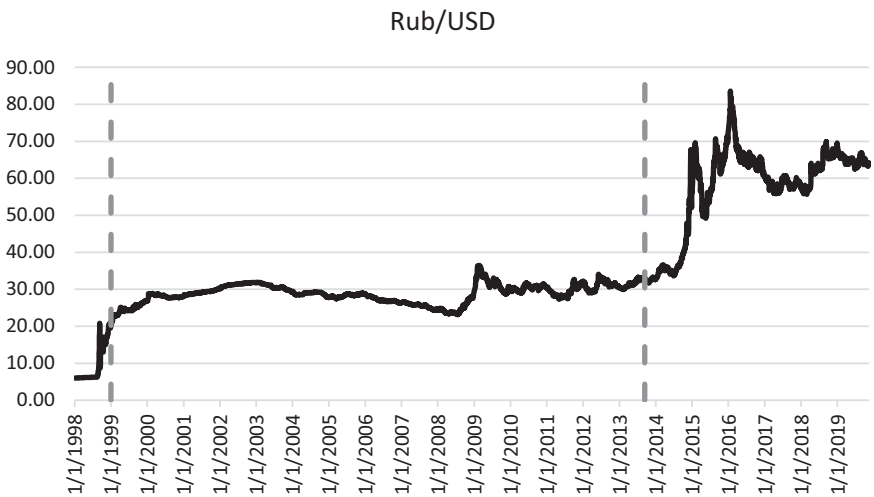

Figure 11.3 Rate of the Ruble to the US Dollar

Note: The vertical lines represent the beginning of a new MR period.

Source: The Bank of Russia, *Dynamics of the official exchange rates*, viewed 14 November 2019, http://www.cbr.ru/eng/currency_base

already done in the two segments – ruble/dollar and ruble/euro and that was done on the stock exchange as well as on the foreign exchange market. Since February 2007 the weight of the euro increased – the dual currency basket contained 45-euro cents and 55 American cents. After the crisis in 2008 and in early 2009 the control over the exchange rate weakened and the CB discretion increased.

It is important to point out here that during that period as well as during previous ones and until 2014 banking supervision was at an extremely rudimentary level and according to some observers it was even nonexistent. That was an enormous failure which illustrated the power of social interests related to the banking sector triggered by privatization in the early years of post-communism.[26]

Natural resource rent and controlled exchange rate (2009–2013)

The end of 2008 was marked by a series of external shocks for the Russian economy which automatically affected the volume of the natural resource rent. That in turn triggered a change in the political and business strategies of the leading political and economic elites. The logical result of the adjustment of interests and strategies was the change in the MR. Slowly and gradually the MR began to reorient towards internal objectives and to serve the increasing influence of the "power resource rent" that started to recover its importance. In concrete terms shocks were associated above all with the onset of the global financial crisis which cut the volumes of international trade and consequently of Russian exports. At the same time prices of oil and gas products fell sharply and foreign exchange reserves melted.

In that situation initiatives were launched for changing the MR. First as regards the exchange rate – since January 2009 the CB had introduced a lower and upper limit for the value of the basket, 41 and 26 rubles respectively, and since February 2009 – a mechanism of the automatic correction of the limits of the range of permissible values of the basket. That range was set at 2 rubles and subsequently it was widened. In October 2010 the rate limits were abolished. From 24 July 2012 to 17 August 2014, the width of the range became 7 rubles, and since 18 August 2014–9 rubles.

It is noteworthy that from 1 October to 7 October 2013 the CB and the Ministry of Finance declared a new regulation for the replenishment and expenditure of the sovereign funds. Thus, the discretion regarding the exchange rate increased. The Treasury became particularly active. On 7 October 2013 a new technical detail was introduced – an additional "technical" internal range for non-intervention of the CB (0.1 ruble), and the "neutral" range was extended from 1 to 3 rubles. Hence two ranges emerged – "neutral" (3 rubles) and "technical" (0.1 ruble) whereas the total fluctuation became 3.1 ruble (within which range the CB did not intervene).

A particularly important component in the structuring of the MR which would be of major importance in the third period was the emergence of MP

objectives and instruments related to restoring the active management of internal liquidity, that is, by building an internally oriented MP. It was about the restarting of the repo operations in late 2008 and their intensive utilization from 2011 to 2014 (see Golovnin [2016]). The repo right rate became the main instrument of the MP. The logical conclusion of that process was the adoption (on 13 September 2013) of the percentage of direct weekly repos for the CB's base interest rate. Therefore, we are justified in claiming that that date (certainly not automatically) marked the start of the next third stage. Inflation targeting (IT) was introduced at the third stage as well as the active management of the interest rate and the switchover to the floating exchange rate. The latter two components became structural ones for the new MR (IT) which was oriented towards internal objectives and power resource rent.

Falling natural resource rent, a floating exchange rate and inflation targeting (2013–present)

The 2008/2009 crisis (the crisis of the private corporate debt) was followed by other serious geopolitical shocks. A turning point was the annexation of Crimea in 2014 which resulted in the imposition of sanctions by the EU and the United States and in the imposition of counter sanctions by Russia. Russia was gradually isolated from the main trade and capital flows of the world economy. The prices of oil and gas products continued to decline and fluctuate on the international markets at levels marking the limit for maintaining Russian public finances and for servicing the private external debt. Foreign exchange reserves were increasingly melting as were the accumulated sovereign funds (Figure 11.4).[27] The late 2014 and early 2015 were marked by a distrust in the banking system, rapid devaluation of the ruble and a strong inflation (see Golovnin [2016], p. 171). The CB quickly increased the base interest rate (key rate) which reached 17% on 16 December 2014. The keeping of foreign exchange reserves became a major objective in the situation of isolation and international hostility.

Following the new internal and external configuration, the institutional components of the MR (objectives and instruments) continued to change. First the exchange rate continued to be liberalized and its free floating was announced in November 2014 in connection with the transition to IT. On 22 May and 17 June 2014, the volume of interventions in the exchange rate range was reduced by 100 million dollars and as of August 18, 2014 it was reduced to 0 dollars. The rule was reintroduced in late December 2013 that in the event of accumulated intervention of 350 million dollars the limits of the intervention range were automatically moved by 5 kopeiki.[28] The targeted interventions were discontinued on 13 January 2014 in connection with the transition to a floating rate.

Discretionary monetary instruments were developed as well. Today the mechanics of base interest rates approaches that of the developed countries' CBs. The main instrument is the interest rate on the daily basis of the weekly

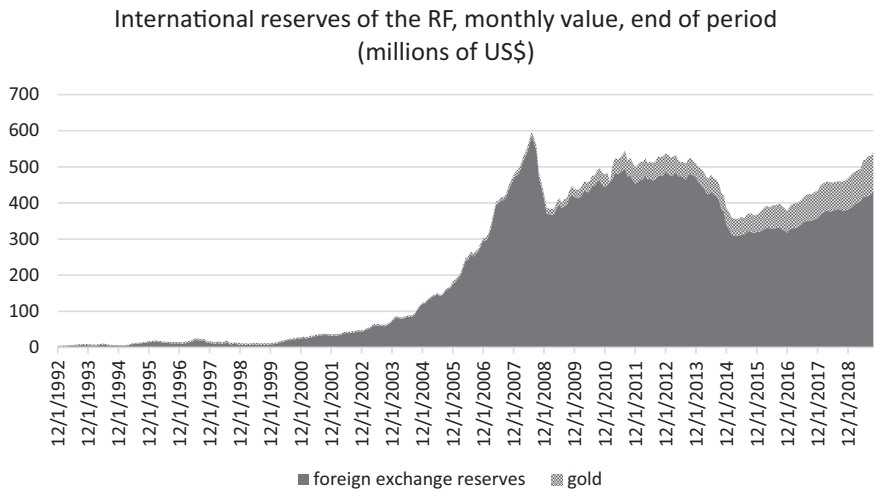

Figure 11.4 Dynamics of the foreign exchange reserves

Source: The Bank of Russia, *International Reserves of the Russian Federation (End of period)*, viewed 14 November 2019, www.cbr.ru/eng/hd_base/mrrf/mrrf_m/

auctions (repo transactions in injecting liquidity and deposit auctions in absorbing liquidity). The range of fluctuations of the interbank interest rates was determined by the two marginal interest rates on the overnight standing facilities (limit +/-1%). At the same time irregular auctions were held for "fine tuning" (period of 1 to 6 days), as well as for providing/absorbing liquidity for longer periods. Of interest were the bonds issued by the CB in order to reduce the high volume of liquidity in recent years. Those bonds could be traded on the secondary market and could in turn serve as collateral in the event of liquidity.

Since November 2014 and above all since early 2015 the official position of the CB had been the transition to the MR of IT (price target of 4%), and to the floating exchange rate. The website of the bank published the Russian translation of the Practical Guide for conducting IT by the Bank of England (Hammond 2012). In addition to price stability the CB's objective was also financial stability.[29] Like all modern banks it published a report on MP. As regards the floating ruble the motives of the CB were as follows:

> The floating exchange rate functions as an 'automatic stabiliser' for the economy, which is its main advantage compared with the managed exchange rate. It facilitates the economy's adjustment to changes in external conditions by mitigating the impact of external factors.
>
> By increasing the economy's dependence on external environment, the fixed or managed exchange rate also makes the monetary policy dependent on other countries' policies and external economic situation. Under the

> managed exchange rate regime, in response to changing external conditions the CB is forced to intervene to influence the domestic currency, thus adversely affecting other economic parameters, including inflation rate. The floating exchange rate allows the Bank of Russia to conduct an independent monetary policy aimed at resolving domestic objectives, and primarily – at reducing inflation.[30]

Although in a vague form, the aforementioned quotation illustrates the assertion that the introduction of IT was rather a consequence of the desire to switch over to a floating exchange rate regime. That was in turn a function of the need to protect and even to raise foreign exchange reserves and to isolate the Russian economy from the global financial and political inflows. That is Russia's strategic objective was to switch over to developing its internal sources of development. Moreover, IT was a formal monetary rule, the MR, which was extremely useful from an "ideological point of view" because it brought the country closer the developed market economies. According to S. Aleksashenko:

> I am ready to suppose that neither in the Kremlin nor in the White House (the authors: the Government) or in Neglinnaya (the authors: the Central Bank) a possibility for en masse support of the ruble at the expense of spending the currency reserves was considered in earnest.
>
> (Aleksashenko 2019, p. 128)

Concluding remarks

In this chapter we have set forth a political economy interpretation of the development of the MR in post-Soviet Russia. Its nature and evolution have been dwelt upon as a result of a function of the struggle of the leading groups for the realigning, distribution, control and reproduction of the leading rent resources. The dynamics of the rent and its alternation – privatization, natural resource and power resource rent – have determined the nature of the MR and of the MP. For their part the MR and the MP have been considered to be major institutional mechanisms coordinating the distribution, reproduction and evolution of the rent. Against a historical background for the past 30 years we have established three main monetary regimes – (i) a vague one which can be referred to as an "issue or inflationary one," (ii) exchange rate targeting, and finally (iii) inflation targeting, related respectively to alternating various rent sources (consecutively – (i) power rent [privatization], (ii) natural rent, and (iii) again power rent).

The historical reconstruction set forth makes it possible to consider the place of the CB, its independence as well as the character of the monetary institutions (and the institutions as a whole) in post-soviet countries such as Russia. In brief, we may point out the following.

With small exceptions CB is not an independent institution, it is included within the common institutional framework of the Russian economy which as

we have already pointed out has been directed at using definite rent resources. And despite the definite formal approximation with the formal rules of independence over the past years it is clear for everyone that CB is a politically subordinate institution.

The heaviest dependence was certainly evidenced during the first period when the new capitalist structure was developed and when the CB was entirely subordinated to the central government and to the president. A flagrant example of an interference was for instance the decree of Boris Yeltsin of May 22, 1996, according to which the CB had to transfer to the Ministry of Finance its profit of 1994 to the tune of 5 trillion rubles (see Aleksashenko [1999], p. 76).

During the second period of favorable conditions and particularly in the beginning (1999–2004), the CB was not subjected to strong pressure and pursued its policy relatively independently (above all that of sterilization of external money flows). According to many observers, it was no accident that the property rights were most stable and the general rules of the game were observed.

The third period after 2014 was a regime of sanctions. The CB was a function of Russia's strategy of self(isolation) from the world economy and of reducing its dependence on the international financial and trade markets. Currently, from a formal institutional viewpoint the MR in Russia – IT – is like that in the developed countries. Actually we consider that that regime was just a front screening other institutional objectives and rules. They were related to the fact that the exchange rate would not be defended because the CB had to accumulate currency reserves and to participate in mobilizing the internal rent sources. The property rights were again extremely unstable similarly to the first period. The total failure of the bank supervision in Russia which resulted in huge costs for the budget in tackling the bank crisis in 2014–2016 (about 4 and more % of the GDP according to some data) brought the nationalization of the banking sector (about ¾ of assets were state owned). That resulted in the total concentration of credit resources in the state and their potential channeling towards definite group interests.[31]

Against a general methodological background, the question of principle remains open – the extent to which the formal institutions in Russia have the same importance as those in the West. Actually, their content was radically different from that of the developed market economies (some Russian authors referred to a "deformalization of rules"). The political economy of the MR which we have presented here in a simple and hypothetical form aims precisely at providing food for thought and direction for future research.

Although the Bank of Russia managed to keep its target of 4% in late October 2019 the Bank of Russia reported a lower that envisaged forecast for inflation for 2019 (3.2–3.7%) and for 2020 (3.5–4.0%). It was announced that deflation risks were higher than inflation ones. There followed a decrease of the interest rate to 6.5% and a further decrease was announced for December 2019. At the same time in her statements the CB governor Elvira Nabiullina (e.g., her speech in the Duma on November 6, 2019[32]) has increasingly stressed the need for the state (by means of the budget and the fiscal policy) to increase its expenditures

including those for investments (the lack of investments has long since been pointed out as a key problem[33]). All this is an evidence that the mechanisms of the third period of the development of internal resources follow their own logic.[34] In the long term that logic could result in the increase of domestic sources of the money supply and, at a definite stage in the choice between depreciation of the ruble or in the introduction of currency and capital control.[35]

Notes

1 Noteworthy is the extremely interesting literary and historical work of E. Pismennaya "On a large scale" ("Po bol'shomu schetu"), dedicated to the history of the Russian Central Bank since 1990 to date based on the personal stories of the bank's governors. This book offers a genuine political economy (Pismennaya 2019).

2 There is certainly extensive literature on international political economy of the monetary and exchange rate regimes (see Broz and Frieden [2008] and Cohen [2015]).

3 For an overview of economic consequences of rent seeking, see Tullock 1967 and Appelbaum & Katz 1987.

4 We should consider that in most transition countries high levels of rent-seeking were possible only in the first years after transition, but the energy sector offered greater possibilities (Treisman 2014, p. 284).

5 A serious research on the development of the political economy of Russia is presented in Vercueil (2019); especially Chapter 6 develops some similar ideas about the rent economy in Russia.

6 We must recall here that it is a matter of a privatization radically different in scope. The private sector in Russia developed from scratch. In the mid-1980s oil prices began to fall and the resource rent and the foreign currency proceeds melted. At the same time Russia was heavily dependent on imports of grain above all (the drama related to the foreign currency proceeds was described in detail by Illarionov and Sachs [1995], Gaidar [2007] and Gaidar and Chubais [2011]). The entire dynamics of processes during the first few years was analyzed in full in the report of the World Bank (1992). See also Petrakov (1998, especially pp. 88–286). Academician N. Petrakov has been an active participant in the discussions on reforms during this period.

7 As regards privatization and its mechanisms, see also Glinkina (2006) and Herrmann-Pillath (2017). The privatization's contribution to the budget was insignificant (it accounted for 0.13% of the total revenues for the 1992–1995 period). Gaidar & Chubais 2011 acknowledged the mistake related for the voucher funds and dwelt on his version of the "loans-for-shares auctions" (in 1995) when the banks were offered the deal of "a loan for the government against property namely shares of state enterprises".

8 A total of 1,400 banks emerged within an extremely short time.

9 There were six banks at the end of the communist period – Gosbank, Vnesheconombank, Sberbank, Promstroybank, Zhilsocbank, and Agroprombank.

10 The CB management under G. Matiukhin could be considered independent in a "western" manner and that openly resisted the attacks of politicians. Within a short time and in extremely difficult economic and political conditions that management succeeded in laying the foundations of a modern two-tier banking system.

11 According to Matiukhin 2017 [1993]:

> The government continued to consider the CB as a bottomless barrel of credit resources and the parliament now and then adopted decrees on soft loans to different sectors of the economy. . . . If in the first six months of 1992 the CB issued 561 billion rubles directly to the national economy it issued 858 billion rubles in the next 4 months. In addition, indirect lending to the national economy through sectoral ministries had increased several times. Thus, if such loans granted by the CB

> amounted to 441 billion rubles for the first half of the year by November 1992, they rose to 1,366 billion rubles. Prices rose by 18% in July and by 25% in August and by 27% in September and 30% in October.
>
> (Matiukhin 2017 [1993], pp. 57, 74)

12 There is much evidence to this effect in archived documents (Illarionov A 2013, "Why did Gaidar fire Matiukhin?," *LiveJournal*, web blog post, 5 March 2013, viewed 25 July 2019, https://aillarionov.livejournal.com/510963.html). Particularly illustrative is the documentary which can be seen in youtube (online video, viewed 14 November 2019, www.youtube.com/watch?v=qgu2hxVw7bI). Those years also saw the emergence of the proposals for the introduction of a Currency Board (see Hanke et al. [1993]), and later that system was also proposed by the IMF representatives.

13 According to A. Illarionov's testimonials, the real reformer and "hero" was the Finance Minister B. Fedorov, a principled man, not E. Gaidar, who, to the disappointment of the Liberals, does not differ significantly from other pro-inflation economists (Illarionov 2010).

14 What is interesting is that the behavior of the CB in those years reminds of the theoretical viewpoint of "issue economy" opposed to "tax economy" (promoted by S. Falkner, O. Schmidt), which was popular during the first years of Bolshevik power. As regards the model of "issue economy," the state could exist forever by emitting money without being hit by inflation.

15 During the 1993–1995 period an important role was played by the established "Credit Commission" which coordinated the standpoints of the government and of the CB as regards the volumes and limits of the credit emission.

16 In theory the depreciation of the ruble was prompted by the need to stop the actual overvaluation of the ruble. At the same time foreign exchange reserves reached a very low level.

17 Notwithstanding the claims that attempts were made in 1995 at switching over to a new regime, at restricting crediting, at a corridor of the exchange rate 4300–4900 rubles per dollar.

18 An exhaustive analytical material about the GKO market was provided by Illarionov and Sachs (1995), chapter 3.4 and the annexes. Most data have been taken from there. Generally, the Russian crisis of 1998 was deeply studied and exposed in different interpretation (see, e.g., Montes & Popov 1999; Aleksashenko 1999; Vavilov 2001).

19 See Yakovlev 2001; Volkov 2005; Barsukova 2017 [2015].

20 Thus, for instance, the pressure of Vice President A. Rutskoy in April 1992 for granting a credit to the tune of 7 billion rubles to Vozrozhdenie Bank which was close to him against the threat for governor G. Matyukhin and deputy governor V. Rasskazov to be fired in a week's time. That fact was announced publicly by Rasskazov himself in the presence of Rutskoy (Matiukhin 2017 [1993], 70).

> The monetary emission aimed at enriching the financial intermediaries standing between the 'monetary authorities' – Central Bank, Ministry of Finance and the State Property Committee – and the rest of society. During the 1992–1993 period they became fabulously rich by the distribution of cheap loans, by 'scrolling' funds between state-owned enterprises and the budget.
>
> (Simonyan 2016, p. 73).

According to Aleksashenko (1999), the main guilt for the failure of the monetary policy (despite the attempts of the CB and the IMF) during that period was to be sought in the failure of the fiscal base of the state and in the public finances as a whole. Aleksashenko did not go further to expose the actual driving forces behind the failure of public finances. Ilarionov, for his part, believes that the introduced exchange rate corridor (with the participation of S. ~~Alexashenko~~ himself) is one of the leading factors leading to the 1998 crisis, Illarionov 2010.

21 See Kapeliushnikov 2016.

22 Still, according to observations two-thirds of the increased rent were due to prices, and only about one-third was the result of the efforts of enterprises engaged in exports.
23 That statement can be disputed.
24 It is noteworthy that profits in the natural resource sector were extremely high due to the low cost of the extraction. Thus, for instance according to reports for 2015 the cost of extraction for Rosneft was 2.6 dollars per barrel or 30-fold lower than market prices of oil. As regards Gasprom, prices were 13 dollars per cu m or 12.5–14-fold lower than market prices (Inozemtsev 2018, p. 124). As regards sovereign funds, see Kudrin (2006), Navoy and Shalunova (2014), and Dabrowska and Zweynert (2015).
25 See The Central Bank of Russia, *The History of the Bank of Russia FX policy*, viewed 10 August 2019, www.cbr.ru/eng/DKP/exchange_rate/fx_policy_hist/
26 We cannot but mention also the murder in September 2006 of the deputy-governor responsible for the banking supervision, A. Kozlov, who was among the few who tried to improve the control on banks.
27 On the dynamics of the balance of payments in the conditions of the 2014–2017 shocks, see Navoy (2017).
28 Consequently, with the rate fluctuations related to Crimea that sum rose to 1,500 mil for a short time.
29 According to Art. 3 of the Federal Law, "On the CB of the Russian Federation" the main goals of the CB are to ensure the stability of the ruble, strengthen the national banking system, ensure the stability of the national payment system and of the national financial market. As a consequence, maintaining financial stability can be regarded as an implicit goal.
30 The Central Bank of the Russian Federation, Exchange rate regime, viewed 2 August 2019, www.cbr.ru/eng/DKP/exchange_rate/
31 Without going into details, we must note that the IT in Russia has been repeatedly criticized as being inappropriate and intangible for the development of Russia and its financial structure (see, e.g., Vedev [2019], "I don't really understand this spill of free floating," Speech presented at the Moscow International currency association conference, 1 July, viewed 5 November 2019, www.iep.ru/ru/sobytiya/aleksey-vedev-ya-ne-ochen-ponimayu-etu-stepen-svobodnogo-plavaniya.html). For a deeper discussion about the limitations of IT in Russia, see our recent paper Nenovsky & Sahling 2019.
32 Statement by Bank of Russia governor E. Nabiullina at the Federation Council, 6 November, viewed 10 November 2019, www.youtube.com/watch?v=BMz7NwPpw9Q
33 See Aganbegyan (2019), as well as Aganbegyan (2018), in particular Chapter 5 "The Reduction of Investments – Ruin for the Economy, the Growth of Investments – a Path towards Its Growth" and Chapter 9 "The Investment Credit – a Key Form of Overcoming the Decline of the Socio-economic Development of Russia".
34 The work on this chapter was finished in November 2019 and later developments have not been considered. But the most recent events as for example the announcement of a new Government in Russia in January 2020, the recent monetary decisions and the sudden decline in oil prices in March 2020 confirm our views of the domestic orientation of the current monetary regime and the growing importance of internal resources for the country.
35 Aleksashenko's opinion is different, the ruble will remain stable in the long term is not so obvious because the Russian economy remains resource-dependent and lacks competitive markets.

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