

LETTERS TO THE EDITOR: Gerashchenko successor's hard choices

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By PADMA DESAI

From Prof Padma Desai.

Sir, The resignation of Viktor Gerashchenko, the chairman of the Central Bank of Russia, will probably usher in much-needed and long-delayed banking sector reforms in Russia. But difficult policy choices face his successor.

The high oil prices in world markets have conferred an embarrassment of riches to the Russian economy in the form of a positive trade balance of Dollars 50bn in 2001 and foreign exchange reserves estimated at Dollars 32bn in January 2002. The central bank has found it difficult to counter the inflationary impact of the foreign exchange inflows by issuing bonds for sterilising the money supply growth because the domestic short-term interest rate, at annualised 25 per cent, is far higher than foreign rates. Such soaking up of cash would therefore be costly. Nor are investors in search of high returns likely to pick up the bonds in view of their experience of the government having unilaterally defaulted its rouble debt in August 1998. As a result, inflation running at a current annualised rate of 18 per cent has contributed to the real appreciation of the rouble, which has cut into the competitive advantage of Russian goods.

Does a real devaluation, evidently preferred by the reformers in the government, provide an answer for restoring that advantage? The collapse of the rouble from six to the dollar to 26 on August 17 1998 transformed the relative price advantage in favour of domestic industries contributing to a high gross domestic product growth rate of 8 per cent in 2000. Currently, it will accentuate the inflationary pressures generated by foreign exchange earnings. It will also prevent Russian industry from undertaking genuine cost-cutting measures via efficient energy use, for example. In fact, the continuing surge in Russian oil production has flooded domestic markets with oil supplies, contributed to lower oil prices for domestic users and stalled the pressure for its efficient use. So it is not clear that creating a price advantage by manipulating the exchange rate provides the answer to the urgent problem of the overhaul of Russian industry.

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