Recent Developments in the Soviet Union

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I would like to discuss the monetary and banking situation in my country. The last few years have witnessed quite a number of sweeping changes in the Soviet economy. These changes, including the decentralization of decision making, have substantially contributed to inflationary pressure. According to estimates by the State Statistical Bureau, inflation was 7½ percent last year. This figure includes both the actual price rise and a computed element measured by shortages of consumer goods in the shops (so-called "suppressed inflation"). One can expect that the trend will accelerate in the year to come, given the reforms which have to be introduced within the plans of transition to a market-oriented economy. In this context the necessity of enhanced power for the State Bank becomes exceptionally vital to influence these developments. Adapting to market conditions makes it inevitable to elaborate and monitor a new type of monetary policy.

For many years the Soviet economy was not affected by inflation, at least not by the open increases of prices, because all prices were fixed by the government. Such a phenomenon as price elasticity was virtually unknown in the centrally planned economy. Any disequilibrium between supply and demand used to take the shape of commodity scarcity. So whenever inflationary factors were at work, they were predominantly of a "demand-pull" character. "Cost-push" factors emerged in the Soviet economy when economic entities got more freedom in the decision-making process, particularly in setting wages and salary levels. In previous years, due to the very strict limitation over the level of salaries and total payroll, control over inflation through administrative measures worked satisfactorily. During the last two years as economic liberalization started evolving, the average level of salaries has gone up more than 13 percent. Coupled with stagnation (and even decline) of production, the scarcity of consumer goods increased and an inflationary trend was ignited. Monopolism of enterprises that produce many kinds of goods and the absence of competition in many industries account for the fact that production lags far behind private incomes. Therefore a sensible price control mechanism is unavoidable in my country unless proper measures to demonopolize industries and increase competition can be put into effect.

No matter what future steps the government takes, it will face the problem of a so-called "monetary overhang." This problem is widely discussed in the national press and abroad. From my point of view, it is grossly misinterpreted. The figures of estimated surplus demand are sometimes fantastic, having nothing to do with realities. According to our calculations, unsatisfied consumer demand, expressed in money terms, stands at about 100 billion roubles, a figure equal to one-ninth of the annual GNP, or one-quarter of the annual turnover in the consumer market.

There are several solutions to the problem. One is just the simple increase of production of quality goods and services to households, Conversion of defense industries, which is now under way, can substantially contribute to the solution of the problem of the consumer goods' productive capacities.

Another way is to provide investment opportunities for the population. These opportunities should, first of all, be linked to housing policy. The rental rate in my country for housing in the cities was fixed in 1927 and has not been revised since. This rate does not even cover maintenance costs today. The new rental rate should encourage households to invest in property.

If the government succeeds in encouraging private investment in housing, that will ameliorate public finance. The buying out of flats from the state will drastically reduce the government debt. At the beginning of 1990, that debt was 400 billion roubles. The estimated value of the housing stock in cities is 364 billion roubles. If sold to inhabitants, the proceeds could thus be used to pay off most of the government debt, and the existing monetary overhang could also be absorbed in this fashion.

Reforming the price-setting mechanism is the next acute and vital problem for my country. Unless it is done, it will be impossible for the banking system to introduce sensible interest rate policies. If an enterprise makes no profit because prices for its products are deliberately fixed by the government, it cannot afford to tap credits at market rates. It needs subsidized money, that is, soft loans. On the other hand, the general level of interest rates in my country will become economically rational when savings banks start to pay the population a fair rate of interest compatible with the current rate of inflation instead of the 2 to 3 percent paid out now. It is important that households have confidence in their financial wealth in an inflationary environment.

The main source of the inflationary pressure over the past four years was the budget deficit. We quite realize the necessity of controlling inflation through cutting the budget deficit, primarily through squeezing centralized investment spending. We have made certain progress in this respect lately. For example, the current budget deficit for the last six months has been below the projected figure of 60 billion roubles for all of 1990. What is also important is the fact that the U.S.S.R. Ministry of Finance intends to borrow this amount entirely from enterprises and the population through different types of bonds. So far it has issued Treasury obligations with a 5 percent interest rate and redemption dates between 1996 and 2000. I am not sure that this type of bond will work. I think the interest rate needs to be higher and the maturity shorter for the issues to succeed.

We have to transform the historic relationship between the government and the monetary system. At the moment, the State Bank of the U.S.S.R. automatically has to credit the government budget deficit, execute every order of the government to cover the financial loopholes in the budget with additional credit, and issue fiduciary means of payment. The same principles govern our interest rate policies where Ministry of Finance considerations about the debt-servicing costs dominate, rather than an anti-inflationary spirit.

In the subordination of the central bank to the government's search for funds, there is always a temptation for the latter to finance economic and social programs through the "printing machine." The draft law on the State Bank of the U.S.S.R. now under consideration in the Supreme Soviet is likely to stop this inflationary bias.

At the same time, we understand that the independence of the central bank from the government is not a solution in itself. Along with the development of a full-fledged market in the U.S.S.R., the role and responsibility of the State Bank in maintaining the stability of the national monetary system will unavoidably grow. This will require a close relationship between the central bank and the government in pursuing coordinated economic and monetary policies.