THE EFFECTIVENESS OF MONETARY POLICY IN THE EURASIAN ECONOMIC UNION

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ABSTRACT

Whereas the establishment of all previous alliances in the post-Soviet space was motivated by a desire for political union, the Eurasian Economic Union (EAEU) has focused on the economic component.[1] *One of its goals has been defined as a transition to a coordinated and concerted economic policy, including fiscal and monetary policies. Some decisions in this area are already being taken. But in light of the global financial and economic crisis, central banks have had to pursue a looser monetary policy, while governments in all EAEU countries have increased their influence on central bank decisions. There are differences in this respect: in some countries (Belarus and Russia), the primary objective of the central bank has not been identified at all and there is a multiplicity of objectives (see Table 1); in others, one and the same objective—the achievement of price stability—is defined as both the objective of the monetary authority and the goal of its monetary policy. In Belarus and Russia, price stability is regarded as a means of ensuring the stability of the national currency (the ruble). In order to coordinate the key elements of monetary policy across the EAEU, the authors suggest setting a primary objective for the central bank, vesting it with exclusive authority in the area of monetary policy, and increasing its real independence.*

[1] See: O.A. Koryakovtseva, I.I. Doronina, T.M. Panchenko, I.S. Karabulatova, Z.M. Abdullina, "Research of Category 'Motivation' as a Basic Tool of Personnel Management," *International Review of Management and Marketing*, Vol. 6, No. 1S, 2016, pp. 293-299.

KEYWORDS: ***Eurasian Economic Union (EAEU), monetary policy, central bank, central bank independence, monetary policy instruments.***

Introduction

As integration within the Eurasian Economic Union (EAEU) increases, its members are planning to coordinate the key elements of their monetary policies.[2] Although the documents of the Eurasian Economic Commission, the executive body of the EAEU, provide for the possibility of establishing a single monetary authority (similar to that of the EU countries) by 2020 with a transition to a single currency, we believe such a scenario is unlikely for a number of reasons.

- First, such a decision would mean a loss of sovereignty and independence in creating money, a prospect for which the member countries are still not ready.
- Second, emerging countries that mainly export raw materials (Kazakhstan and Russia) depend to a significant extent on external factors: world prices and changes in the terms of trade, which are beyond the control of the monetary authorities.
- Third, in order to coordinate certain elements of monetary policy, the member countries will have to harmonize their banking laws with regard to the objectives of the central bank

[2] See: I.N. Chuev, T.M. Panchenko, V.S. Novikov, O.A. Konnova, N.G. Iraeva, I.S. Karabulatova, "Innovation and Integrated Structures of the Innovations in Modern Russia," *International Review of Management and Marketing*, Vol. 6, No. 1S, 2016, pp. 239-244.

and its monetary policy, as well as the powers of the monetary authority in its development and implementation.

- Fourth, the deep geopolitical and economic crisis and the dependence of the EAEU economies on the economy of Russia (in 2015, it accounted for 35% of imports in Armenia, 62% in Belarus, 42% in Kazakhstan, and 53% in Kyrgyzstan) have led to a significant worsening of the situation in the banking sector. For example, transfers from Russia to Armenia fell by 14% in 2015. Let us note that the Russian banking sector dominates in the EAEU with almost 92% of the latter's total bank assets.
- Fifth, the imbalances between countries in many economic indicators (structure and growth rate of the economy, external public debt, foreign exchange reserves, etc.), including significant differences in inflation rates (see Table 1), have not only persisted, but have further increased. In 2015, inflation rates in most countries not only failed to meet the criterion for sustainable development established by the Eurasian Economic Commission, but also differed widely: from 4.3% in Armenia to 13.6% in Kazakhstan. As a result, each member country failed to meet at least one of the sustainability criteria (Armenia formally met them all, but only because the debt of the monetary authorities was excluded from the category of public debt).

Table 1

Analysis of Conformity with Sustainable Development Criteria in EAEU Countries in 2015

Countries	Annual Consolidated Budget Deficit, % of GDP		Public Sector Debt, % of GDP		Inflation Rate, %*		Projected Inflation Rate for 2016, %
Armenia	≤3%	–2.9	≤ 50%	48.7	9.3%	4.3	4.0 ± 2.0
Belarus		1.5		37.8		12.0	12.0
Kazakhstan		–2.7		22.1		13.6	6.0-8.0
Kyrgyzstan		–7.7		68.1		8.1	9.8
Russia		3.5		10.3		12.9	6.0

* This parameter should not exceed the EAEU minimum by more than 5 percentage points, that is, considering the inflation rate in Armenia in 2015, it should not exceed 9.3%.

Source: Compiled using data from the Interstate Statistical Committee of the CIS [http://www.cisstat.com/] and the Eurasian Economic Commission [http://www.ereport.ru/stat.php?razdel=country http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_stat/finstat/Documents/finstat_2015.pdf], 15 December, 2016.

In addition, the EAEU countries use different targeting regimes, although prior to 2006 all of them used monetary targeting (targeting of monetary aggregates), with the money supply as an intermediate target, and the monetary base as an operational target. At the same time, the monetary authorities also occasionally resorted to exchange rate targeting (Belarus, Kyrgyzstan), in some periods actually using a mixed model in which exchange rate targets were combined with several monetary targets. Later on, the member countries began a gradual transition to inflation targeting (Armenia in 2006, Kazakhstan and Russia in 2015, and Belarus is planning to transition by 2020). Kyrgyzstan is

still undecided on whether to introduce inflation targeting. Although Kazakhstan and Russia have announced their transition to inflation targeting, this transition can be regarded as nominal due to the heavy dependence of their economies on world energy prices and the depreciation of their national currencies, which leads to rising prices for imported goods.

The periods covered by the Monetary Policy Guidelines developed in individual EAEU countries do not coincide either. Despite such differences in many economic indicators, one should note the "accidental" coincidence of similar actions by the central banks in the conduct of monetary policy: the lowering of reserve requirements in 2007-2009, the introduction of unsecured loans, etc. But due to the lack of a comprehensive approach to monetary policy in the crisis and post-crisis periods, its effectiveness has declined: the expected parameters of the money market have not been achieved, national currencies have depreciated, GDP and credit to the economy have declined, etc.

Methodology

The effectiveness of monetary policy is usually measured by indicators such as the growth rate of GDP, the money supply and monetization (normally, the monetization ratio should be 50% or higher, but in Russia it is much lower); the relationship between the growth rate of the money supply and GDP; the ratio of credit to GDP, and others.

Apart from that, some authors have argued the existence of certain patterns ("rules") in the development of the money market in emerging economies:[3]

1) there is an inverse relationship between the growth rate of the money supply and the monetization ratio: as the rate of money creation increases, the monetization ratio usually decreases;
2) if the annual inflation rate measured by the GDP deflator is less than 20%, the monetization ratio usually tends to increase; if it is in the range of 20% to 40%, the monetization ratio fluctuates; and if the annual inflation rate is over 40%, the monetization ratio steadily decreases;
3) the dynamics of average annual growth rates of the monetization ratio are usually positive (i.e. have a positive impact on the national economy) if its growth rate exceeds the GDP growth rate by no more than 40% per year. In this case, the higher the level of monetization the higher is the rate of economic growth, the higher and more diversified is the demand for money, and the larger are the money flows redistributed to finance economic development. Otherwise, the dynamics of the monetization ratio may inhibit economic growth in the country, lead to excessive dependence on short-term non-resident investment, weaken the resource potential of the financial sector, and push up the price of money in the economy.

Results

A comparison of actual macroeconomic indicators with their expected values shows that in the pre-crisis period (to 2007) the actual values of most variables were generally consistent with the target values (see Table 2). In the following years, however, many of the achieved indicators worsened significantly compared to their expected values.[4] For example, the inflation target for 2015 was

[3] See: A. Illarionov, "Zakonomernosti mirovoi infliatsii," *Voprosy ekonomiki*, No. 2, 1997, pp. 30-57.

[4] See: Zh.G. Golodova, Yu.S. Ranchinskaya, "Analiz mer i rezultatov denezhno-kreditnoi politiki v stranakh Tamozhennogo soiuza v krizisnyi i post-krizisnyi periody," *Natsionalnye interesy: prioritety i bezopasnost*, No. 42 (279), 2014, pp. 2-11.

achieved in Armenia and Belarus (in Kyrgyzstan, the actual figure was better than expected); the target for money supply growth was achieved in Kyrgyzstan, and for GDP growth in Armenia. In some periods, economic growth in Armenia, Belarus and Russia was negative.

Table 2

Monetary Policy Parameters and GDP Growth Rates in EAEU Countries *(%)*

Countries	2007		2009		2015	
	plan	fact	plan	fact	plan	fact
inflation rate						
Armenia	4 ±1.5	6.6	4 ±1.5	3.4	4 ±1.5	3.7
Belarus	6.0-8.0	10.3	9.0-11.0	13.0	12.0	12.0
Kazakhstan	4.1-5.5	18.8	8.5-10.5	6.2	6.0-8.0	13.6
Kyrgyzstan	5.0-6.0	20.1	15.0	0.0	5.0-7.0	3.4
Russia	6.5-8.0	11.9	7.0-8.5	8.8	5.5-6.9	12.9
growth rate of M2 money supply						
Armenia	n/a	42.3	14.0-16.0	15.1	none	10.8
Belarus	25.0-29.0	25.0	32.0-40.0	–7.8	none	40.9
Kazakhstan	25.7	25.5	23.5	17.9	4.0	34.0
Kyrgyzstan	none	44.2	none	17.9	14.0-15.3	14.9
Russia	19.0-29.0	47.4	19.0-28.0	17.7	7.0-11.0	11.5
monetization ratio						
Armenia	none	22.0	none	25.9	none	36.9
Belarus	14.3-14.6	13.4	16.5	13.3	none	10.4
Kazakhstan	33.7	38.6	33.1	46.5	31.8	32.0
Kyrgyzstan	none	30.8	none	29.1	none	33.8
Russia	none	38.7	none	40.4	none	44.5
GDP growth rate						
Armenia	9.0	13.8	9.2	–14.4	1.6-2.6	3.0
Belarus	8.0-9.0	8.2	10.0-12.0	0.2	0.2-0.7	-3.9
Kazakhstan	9.6	8.7	0-6.3	1.2	1.5	1.2
Kyrgyzstan	n/a	8.2	6.0	2.3	4.8	3.5
Russia	5.0-6.4	8.5	5.7-6.7	–7.8	–0.7-0.6	–3.7

Source: Calculated and compiled using data from the ministries of finance and the central banks of the respective countries and from [http://knoema.ru/atlas].

Another negative trend is that some member countries have reduced the number of indicators in the Monetary Policy Guidelines developed by their central banks for the coming period: Armenia and Belarus have stopped targeting money supply growth, and Belarus, the monetization ratio.

At the same time, the increase in the monetization ratio recorded in Armenia, Kyrgyzstan and Russia should be seen as a positive factor: it means that more of the necessary money is available in the economy and points to growing confidence in the national currency among economic actors. In Kazakhstan, however, the increase in monetization to 32% in 2015 was due in large part to a significant increase in the money supply caused by the revaluation of foreign currency deposits against the background of an economic slowdown. In other words, the situation of 2009, when the monetization ratio reached its highest level for the entire period of market transformation, is repeating itself to some extent.

As for credit to the economy, during the 2009-2010 financial and economic crisis its growth slowed due to an increase in the cost of credit in a more difficult funding situation, as well as to the more cautious policy of commercial banks. Moreover, there was a "credit crunch" in Kazakhstan and Kyrgyzstan, followed by a credit expansion (see Table 3). In Kazakhstan, credit has not yet reached the pre-crisis level, and in Armenia and Russia the credit-to-GDP ratio declined in 2014 and 2015 (the credit slowdown continued in 2016), which is evidence of further recessionary trends in the economy.

Table 3

Dynamics of Banking Sector Credit in EAEU Countries in 2007-2015 *(% of GDP)*

Years	Armenia	Belarus	Kyrgyzstan	Kazakhstan	Russia
2007	13.5	35.1	15.6	56.5	36.3
2010	27.4	54.5	12.6	35.3	40.4
2014	42.7	40.3	19.8	31.8	57.2
2015	39.8	43.5	31.7*	37.7	54.7

* Data for the first nine months of 2015.

Source: Calculated and compiled by the authors using data from the official websites of the central banks of the EAEU countries; *Finansovyi sektor i izderzhki infliatsii v stranakh s perekhodnoi ekonomikoi* (The Financial Sector and Inflation Costs in Transition Countries) (Project of the Institute for the Economy in Transition), available at [http://www.iep.ru/files/text/usaid/fin_sec.pdf], 14 February, 2016.

In the crisis and post-crisis periods, the relationship between the growth rate of the money supply and monetization ratios in the EAEU countries was occasionally not confirmed (see Table 4) because the growth rate of broad money was accompanied by an increase in monetization: Armenia (2004-2007, 2011-2012, 2015), Kyrgyzstan (2005, 2012, 2015) and Russia (2006, 2012-2013). In Belarus (2006-2008, 2011-2012, 2015) and Kazakhstan (2006-2007, 2012-2013), money supply growth slowed with a simultaneous decline in monetization.

The relationship between the GDP deflator and the monetization ratio did not hold in Armenia (2008, 2012-2013), Belarus (2005-2007, 2012, 2015), Kazakhstan (2009-2011, 2013-2014), Kyrgyzstan (2010, 2013-2014) and Russia (2005-2011, 2014).

The inconsistencies with the above patterns ("rules") are largely related to the greater vulnerability of the economies of Belarus, Kyrgyzstan and Kazakhstan, central bank policies designed to

stimulate the demand for money by lowering interest rates (Belarus) or credit crunches caused by the high share of bad loans in bank portfolios (Kazakhstan), which increased the imbalances in money and credit markets.[5] At the same time, these imbalances are smaller in Armenia, which has targeted inflation for more than 10 years, and in Russia, which has a more developed monetary system.

Table 4

Money Market Parameters in EAEU Countries in 2005-2015 ***(annual average)***

Countries	Years	Difference between Growth Rates of M and GDP	Growth Rate of GDP Deflator	Growth Rate of Monetization Ratio
Armenia	**2005-2015**	**13.8**	**3.5**	**9.2**
	2008-2015	**11.2**	**3.3**	**7.3**
	2011-2015	**11.1**	**2.0**	**7.1**
	2014-2015	**6.3**	**1.8**	**4.3**
Belarus	**2005-2015**	**26.2**	**25.9**	**0.2**
	2008-2015	**22.1**	**30.5**	**–5.9**
	2011-2015	**29.2**	**40.4**	**–8.1**
	2014-2015	**8.2**	**17.1**	**–7.7**
Kazakhstan	**2005-2015**	**12.8**	**10.5**	**1.9**
	2008-2015	**11.2**	**7.6**	**–2.8**
	2011-2015	**6.3**	**5.4**	**–6.6**
	2014-2015	**8.9**	**1.1**	**–9.6**
Kyrgyzstan	**2005-2015**	**n/a**	**14.3**	**5.4**
	2008-2015	**10.2**	**9.2**	**2.0**
	2011-2015	**9.0**	**6.4**	**2.0**
	2014-2015	**5.3**	**–0.3**	**0.2**
Russia	**2005-2015**	**111.5**	**19.9**	**5.9**
	2008-2015	**109.7**	**13.9**	**2.5**
	2011-2015	**108.7**	**12.8**	**0.7**
	2014-2015	**107.5**	**5.2**	**0.4**

Source: Calculated by the authors using data from the central banks and statistical agencies of the respective countries.

In recent years, the monetary authorities of some EAEU countries have adjusted their policies: transitioned from a currency band to a floating exchange rate with a switch to inflation targeting (Kazakhstan, Russia), abandoned regular currency interventions (all countries), introduced a key rate

[5] See: Zh.G. Golodova, Yu.S. Ranchinskaya, "Tsentralnye banki stran Tamozhennogo soyuza: kriterii i podkhody k otsenke nezavisimosti," *Natsionalnye interesy: prioritety i bezopasnost*, No. 41 (278), 2014, pp. 2-13.

(Russia) or a base rate (Kazakhstan), etc. As a result, the trend toward the depreciation of national currencies continued. In 2014 and 2015, the most significant decline in the value of the national currency was recorded in Belarus and Kazakhstan (see Table 5), with the head of state of Kazakhstan explaining this by requests from businesses and exporters.[6] But such depreciation leads to an increase in the raw material orientation of the economy, an outflow of capital from the country and a loss of confidence in the national currency, ultimately fueling inflation.

Table 5

"Peak" Depreciation of EAEU National Currencies against the U.S. Dollar* *(%)*

Years	Armenia	Belarus	Kyrgyzstan	Kazakhstan	Russia
2009	23	30		23	
2011		2.8 times			
2014	15	24	20	18	73
2015		56	29	86	29
2009-2015	1.6 times	8.4 times	1.9 times	2.8 times	2.5 times

* Determined as the rate of increase in the value of the dollar for the period.

Source: Compiled based on reports of the central banks of the EAEU countries.

All of this highlights the need to enhance the independence of the monetary authorities in developing and implementing monetary policy.

Discussion

Central bank independence is regarded by many authors as a key condition for improving the effectiveness of monetary policy. In foreign practice, priority was initially given to political independence, which was interpreted in terms of relations between the central bank and the government (A. Alesina), the procedure of appointment and dismissal of the bank's senior officials, the existence of a requirement for government participation in the governing bodies of the bank, etc.[7] Later on, researchers began to consider two aspects of independence: political and economic (G. Debelle, V. Grilli, D. Masciandaro, G. Tabellini). Political independence was understood as the exclusive authority of the central bank to set the final goal of monetary policy; the appointment of central bank officials and the development of monetary policy without government participation; and the existence of legislation establishing the special status and powers of the central bank. Economic independence was characterized by the bank's powers to choose the instruments of monetary policy and

[6] See: N. Nazarbaev, "Nazarbaev prizyvayet privykat k trudnostiam," available at [https://ria.ru/economy/20150820/1197587134.html], 11 September, 2016.

[7] See: L.V. Shkvarya, A.V. Strygin, V.I. Rusakovich, "Geo-economic Factors of an Intensification Development of Laos in Association of Southeast Asian Nation Conditions," *International Review of Management and Marketing*, Vol. 6, No. 6, 2016, pp. 121-125; A. Alesina, "Macroeconomics and Politics," *Macroeconomics Annual*, MIT Press, 1988, pp. 13-52, available at [http://www.nber.org/chapters/c10951.pdf], 10 December, 2016; S.V. Ryazantsev, I.S. Karabulatova, R.V. Mashin, E.E. Pismennaya, S.Yu. Sivoplyasova, "Actual Problems of Human Trafficking in Illegal Immigration in the Russian Federation," *Mediterranean Journal of Social Sciences*, Vol. 6, No. 3 (S1), 2015, pp. 621-626.

determine the extent of government access to central bank credit.[8] Some authors (S.C.W. Eijffinger and J. de Haan) saw the central bank's powers in determining the goals and instruments of monetary policy, as well as its operational independence, as the most important characteristics of central bank independence.[9]

In this context, one can well understand Andrei Makarov, head of the Committee on Budget and Taxes of the State Duma of Russia's Federal Assembly, who said that "even though the Central Bank is a megaregulator, not everything depends on the Central Bank. It is simply that not everything falls within its mandate, but the key factor is that this interaction should not be detrimental to the independence of the Central Bank. The Central Bank's independence is the instrument that makes it possible to conduct this work."[10] But then Makarov said that "one cannot live in the world and be free from society," and this can be interpreted as a kind of recognition of the impossibility of the Central Bank's complete independence.

The second issue being discussed is whether the central bank should set the goal/objective of ensuring economic growth. Of all EAEU countries, only Belarus, Kyrgyzstan and Russia have banking laws establishing that the policy conducted by the monetary authority should promote long-term economic growth (sustainable development). Precisely such an approach has been expressed by Sergei Glazyev, advisor to the Russian president. He notes that during an economic crisis the monetary authority should not set the narrow goal of reducing inflation, but should aim to stimulate economic growth, including through a reduction in the key rate to the level of the average rate of return in the real sector of the economy.[11] In this connection, we believe that the central bank's primary objective should be price stability, while the other objectives should not be in conflict with it.

Conclusion

A transition to coordination of monetary policy elements in the EAEU countries at the present stage of their development is impossible because of significant differences in inflation rates, monetization ratios, and other financial and economic parameters.

For a transition to monetary policy coordination, the EAEU countries should amend their banking legislation so as to identify the primary objective of monetary policy; enhance the independence of the central bank by giving it exclusive authority to develop and implement monetary policy; and build relationships with the government in matters of appointment and dismissal of central bank officials, approval of reports, etc.

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[8] See: G. Debelle, S. Fischer, "How Independent Should a Central Bank Be?" in: *Goals, Guidelines and Constraints Facing Monetary Policymakers*, ed. by J.C. Fuhrer, Federal Reserve Bank of Boston, Boston, Conference Series, No. 38, 1995, pp. 195-221; V. Grilli, D. Masciandaro, G. Tabellini, "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries," *Economic Policy: A European Forum*, No. 6, 1991, pp. 341-392.

[9] See: S.C.W. Eijffinger, J. de Haan, "The Political Economy of Central Bank Independence," *Special Papers in International Economics*, No. 19, 1996, available at [http://www.princeton.edu/~ies/IES_Special_Papers/SP19.pdf], 20 November, 2016.

[10] Report by Andrei Makarov is available at [http://www.komitet-bn.km.duma.gov.ru/site.xp/053053051124052048048050.html], 11 December, 2016.

[11] See: S. Glazyev, "Nevernym kursom idyote, tovarishchi," available at [https://www.gazeta.ru/business/2016/09/16/10197203.shtml], 8 December, 2016.