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Approaches to the Regime Choice and Criteria of the Optimal Monetary Policy of the Transition Period

Choosing optimal monetary policy option has its own history and this problem will be a subject of theoretical studies for a long time. One may speak about the great scientific and practical importance of the problem of choosing the targets and optimal monetary policy regime for every country, especially, for transition economy. At present, the world experience is represented by two basic full-fledged monetary policy regimes though the current classification is relatively contingent and the practice of monetary management itself is represented by the multiple mixed forms of and approaches to the monetary sphere regulation, that evidences the ongoing process of monetary management improvement and revision of the pre-existed theoretical and practical approaches. The evolution of tasks and objectives faced by the central banks is caused, to a great extent, by the development and qualitative changes in the financial sector itself, as well as monetary and economic relations and interrelations.

Every type of activity as well as any policy, whether it be monetary, economic or fiscal, is related to the target-setting process, i.e. availability of a target with a view to attaining which it is designed, as well as determination (development) of the methods and mechanisms for its implementation by means of the specific instruments that each of them has at its disposal. Whereas an economic growth is most often the economic policy target, and that is already axiomatic, as a basis for increasing society's well-being (sometimes, along with other parameters, for example, lowering of unemployment, reduction of inflation, assuring stable balance of payments and etc.) the other components of the macroeconomic policy must have their specific targets that are inseparably linked and aimed at attaining of the strategic targets of economic development (general economic target).

The availability of specific targets derives from and is determined by the specific features of the object of impact itself as well as by the instruments being at the regulatory body's disposal that make it possible to make an impact on the object. As a result, owing to the attainment of specific objectives the synergetic impact of all the monetary policy components on the general target of the economic system is being strengthened.

For example, monetary system is the object of the monetary policy impact. To this effect it has specific instruments (an interest rate, an exchange rate, etc.) and its own channels (a transmission mechanism) of economic impact.

The notion "monetary policy target" was introduced for the first time by Jan Tinbergen. Under it he understood a fixed quantitative parameter which the monetary policy must seek to attain by selecting the values of the policy instruments or instrumental variables (a monetary policy instrument). According to the Tinbergen's concept, monetary policy is characterized by the hierarchy of the target variables: a final target – an intermediate target – the tactical targets – the instruments of the central bank's policy.

But, a monetary policy target itself as well as the principles of the structure of the system (hierarchy) of indicators for its attainment may change that is traced in the historical context.

For example, during the gold standard the final monetary policy objective consisted in the maintenance of the fixed price for gold, or, in other words, keeping the fixed exchange rate. During the

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Bretton-Woods Agreement “the external and internal stability of the national monetary unit” (the fixed exchange rate and low level of inflation) was stipulated as the final target in the laws on central banks. During the period of high inflation, monetary targeting, i.e. the creation of money supply in accordance with the prescribed targets of the money supply growth, proved to be efficient as well. But, when the demand for money became more and more unstable and the relations between the monetary supply and inflation rates less and less predictable the central banks gave preference to the control of the interest rate again. After switching to the floating exchange rates the obligation of the great number of central banks to maintain the fixed parity was annulled and price stability became the final target.

Based on the available approaches to the modification of targets and objectives, the level of attainment of the stipulated target is the most important criterion of efficiency of every policy. The extent of attainment of the stipulated targets may be considered as a criterion of the regime selection and, consequently, the subsequent assessment of its efficiency with reference to the monetary policy.

During the last years a great number of central banks selected reduction and keeping of inflation at a low level as the key monetary policy target. Is price stability guaranteeing constant economic growth and serves as the basic indicator of the economy development? Must the inflation be a priority of the economic or monetary policy? If the above-mentioned questions will be answered unambiguously, then such a target of the central bank as ensuring of the low inflation rates may be considered as the main contribution to the implementation of the economic policy designed to ensure a stable and long-term economic growth.

Unfortunately, at present there is no common understanding of this interrelation. The results of the empirical analysis of the ratio of the inflation dynamics and the rates of the economic growth for the historical period covering 1960-1998 which was carried out by the IMF specialists for 140 selected countries confirm the importance of the inflation for the economic growth, but this interrelation is nonlinear, i.e. the volatility of the economic growth increases as the inflation is growing. Other investigations which were carried out in different countries of the world show that the high inflation rates (that are expressed in two-digit numbers) are accompanied by the low rates of economic growth or economic recession. For example, in the East European countries the economic growth has been resumed after successful lowering of the high rates of the prices growth at the initial stage of transition to the market economy.

S.Moiseev, Director of the Center of Economic Studies of Moscow Financial and Industrial Academy, gives the following comparative macroeconomic characteristic of the countries that are targeting inflation and money supply under independent “floating” of the exchange rate (the median for 1996-2006, in %)[1].

Groups of countries	Economic growth	Inflation
Developing countries that are targeting money supply	5.15	7.95
Developing countries that are targeting inflation	4.2	6.5
Industrial countries that are targeting inflation	3.3	2.3

The given data show that the higher rates of the economic growth are accompanied by the higher level of the consumer prices growth though a lot of economists distinguish several cycles in this in-

[1] S.Moiseev . “Formalization of the Economy and its Consequences for the Monetary Policy” // Issues Related to the Economy No.2, 2007.

terrelation. At a definite stage economic growth invokes the cyclical increase in prices which is followed by the increase in the maximum inflation level and at the final stage the inflation gives rise to the negative economic growth (stagflation).

With respect to the short-term interrelations, some economists believe that the excessive increase in the money supply under the short-term statics (constancy) of prices leads to the economic growth. Later on these processes are counterbalanced by the increase in prices and decrease (suspension of growth) in the real production volumes, i.e. there is a certain level at which the interrelation of the inflation and economic growth becomes inverse, the level for developing countries that are characterized by the structural disproportions and institutional transformations in progress being higher than that for the developed systems.

It should be noted that the results of any comparative analysis of two variables, in our example of inflation and rates of economic growth, may be hardly considered as absolutely unambiguous because it is difficult to distinguish "per se" the impact of the inflation on the economic growth and the reversed impact, as the latter is the result not only of one or another monetary policy but of the whole system of other macroeconomic factors.

In the author's opinion, when selecting one or another monetary policy regime it is necessary, in the first place, to take into account macroeconomic determinants, such as, the structure of the economy and its monopolization level, availability of structural disproportions, price flexibility and pricing mechanism, the extent of the administrative impact on the economy and the share of market instruments, the extent of the transparency of the economy, maturity of the monetary markets and financial system as a whole, transmission channels and mechanisms of affecting the economy, the character of fiscal policy, costs related to the market transformation and establishment of the new market institutions, etc.

The unstable character of the transition economy as a whole and lack of the unambiguous understanding of the transmission mechanism functioning between the money supply and macroeconomic variables complicate the problem of the choosing corresponding monetary policy option and the use of a number of traditional models of monetary regulation. At the same time, when the monetary policy target is being defined it is reasonable to take into account to a maximum degree the impact of the selected target on the economy as a whole.

In other words, when a monetary regime is being selected the following should be taken into account:

- an extent of the selected priority impact on the economic parameters, namely, the dynamics of production and economic activity, as well as on the consumption, savings and investments, i.e., on what do the real economic variables react strongly — exchange rate volatility or fluctuation of prices in the form of inflation growth;
- the available instrumental opportunities of monetary authorities to influence economic variables, for example, what is the reaction of investments and demand for money on the changes in the interest rate;
- the explicit costs of one or another monetary management method and its advantages;
- the potential efficiency limits and productivity loss risks;
- the anti-inflationary capacity of the regime and limited nature of the monetary anti-inflationary regulation in the transition systems as a whole;
- an availability of price-setting processes in the economy of the non-monetary nature and "natural" limited nature of the monetary policy impact on the economic growth;
- a capability of the monetary regime to protect the economy from the external and internal negative impacts, etc.; and

— a time horizon towards which the policy is directed and others.

The statistical investigations of the Russian economists that were focused on the impact of the US dollar exchange rate, inflation and short-term monetary fluctuations on the volumes of production in different branches of industry revealed that none of the branches suffer from the increase in the US dollar nominal exchange rate. But the production is reduced in all the branches of industry (except for the building materials production industry) following an increase in the inflation rates. Among them are: non-ferrous metallurgy, chemical industry, and machinery manufacturing. When the inflation level is being increased the volumes of transportation experience the most significant decrease and the gross profit in the industry reduces sharply as well[1].

Thus, macroeconomic variables such as the exchange rate and inflation make diverse impact on the production volumes in different branches of industry. Increasing inflation rates make a greater adverse impact on the production than moderate fluctuations of the exchange rate.

The investigation that focused on the valuation of the relations between the real exchange rate fluctuations and economic growth in Russia gave rise to the conclusion on the ambiguous character of such impact because it is determined by the reasons that underlie changes in the real exchange rate. If the strengthening of the currency is the result of capital inflows or an increase in the income from exports, the general implications for the economy would be positive. If the real exchange rate is changed due to the increase in the real costs, economic growth would slow down, in the first place, in the import-substituting branches, but the exchange rate reflects only the increase in the costs that cause the slowing down of economic growth. Therefore, the general impact on the economy would, virtually, be equal to zero[2].

The author did not reveal any assessment of such comparative impact with respect to the economy of the Republic of Belarus.

At the same time, in a more general sense, the impact of the exchange rate on the economy is expressed through the stimulation of trade at the expense of foreign exchange risk reduction; impact on the products price competitiveness; stimulation of investments, because the exchange premium of interest rates is being decreased; formation of the internal price dynamics by changing the prices for imports (especially, for the countries with open economies) thus reducing imported inflation, the impact on the exchange rate and inflationary expectations, etc. At present, a lot of countries enjoy progress in the implementation of monetary policy which is based on the use of the exchange rate as a nominal anchor with a view to ensuring macroeconomic and financial stability.

But in the process of setting the exchange rate targets the economy may face some problems. For example, when the financial account is being liberalized and the capital is actively moving the possibilities of a speculative attack on the national currency and practical impossibility to assure, in these conditions, the tackling of the twofold task, namely, to maintain a stable exchange rate and the desirable dynamics of prices, would be strengthened as the central banks' interventions make a diverse impact on the changes in the real exchange rate and inflation growth. The exchange rate policy is unable to efficiently combat foreign exchange speculations based on the objective weakness of the national currency.

Besides, for the purpose of meeting the chosen quantitative exchange rate target significant gold and foreign exchange reserves are required that may be afforded by the country that has the strong foreign economic sector and positive trade balance. At that, the effectiveness of the interest rate

[1] I.S.Ivanchenko. "Inflation Channel of the Monetary Policy Transmission". // Finance and Credit No.17, 2006.

[2] A.Ulukaev, O.Zamulin, M.Kulikov. Preconditions and Consequences of the Inflation Targeting Implementation in Russia.

channel would be weakened and the mechanism of banks refinancing would be functioning inadequately. Under relatively low levels of inflation the restricted anti-inflationary capacities of the exchange rate targeting regime would become apparent (the efforts aimed at reducing the inflation below 10-12% failed in the countries using such a regime). Besides, the central banks' potential to adjust the exchange rate to its long-term equilibrium parameter would be limited.

If the central bank targets the exchange rate the disadvantages of such policy would be also the loss of the ability to carry out an "independent" monetary policy since the changes in the monetary base (reserve money) occur through the foreign exchange purchase and sale operations, in other words, the bank would loss its ability to manage the liabilities side of its balance sheet. Under such regime the internal control of inflation (at least, its monetary component) would be lost.

May these two tasks be complementary and consistent within monetary policy and at what stage does the necessity to abandon the dilemma of target-setting and to focus on one target which becomes single and prioritized arise? Shall the reliance in the national currency be assured under the fixed exchange rate but relatively high level of its domestic depreciation, i.e. inflation?

As it is apparent from the historical experience, the effort aimed at the simultaneous attainment of two targets - the setting of the nominal exchange rate targets and inflation rates — was realized in many countries of Central and Eastern Europe at a definite stage of their economical and financial development, but later on took the form of currency crises. Notwithstanding the importance of the exchange rate channel for the reduction of inflation in many of the aforesaid countries they failed to attain the stable exchange rate and decrease the level of inflation in the changed economy development conditions (in particular, when financial account is liberalized and the real exchange rate is increased).

Under a more flexible exchange rate setting regime the possibility to implement independent monetary policy would arise and in such conditions a central bank may perform a function of the creditor of last resort and provide commercial banks with the required liquidity. The efficiency of one or another liquidity regulation method, including the interest rate policy, depends upon the method of money supply creation which is used in the concrete period of time. At the same time, the exchange rate may play the role of stabilizer in case of the impact made by the adverse foreign trade factors.

The main advantage of the monetary policy implemented under the floating exchange rate lies in the removal of the threat of imbalance related to the inconsistency between the exchange rate and changing macroeconomic conditions and making a serious adverse impact on the economic development.

The adverse impact of the high inflations rates on the economy is well-known as well. In the first place, money savings are depreciated, primarily, the enterprises' fixed incomes, current assets and profits; the development of the securities market is slowed down due to the inevitable partial loss of value of contribution to this asset; dollarization of the economy increases; the high-technology and investment development of the economy is hindered because any innovational decision in the business and in the economy as a whole is fraught with risks, including the inflation risk. If one cannot forecast precisely the dynamics of prices one cannot assess the profits and losses associated with the investment projects.

But, inflationary process in the transition economies is related to the internal instability of such systems, accumulated structural deformations of the reproduction and technological character and inflationary potential. Inflation in such countries is caused not only by the monetary factors, but, to a greater extent, by the disproportions that generate and strengthen the structural and institutional factors of inflation. Therefore, the possibilities of the monetary policy impact on the inflationary processes in these conditions are limited and as macrovariables reach equilibrium state, including structural and institutional characteristics, the monetary system attains greater "inflation immunity".

In these conditions it is difficult to influence the price level through the changes in the interest rate because the internal price structures, including prices for goods and services, as well as the wages are not sufficiently flexible and are adjusted in an administrative way. The influence of the change in the interest rate on the price level would be diverse depending on the initial parameters of the economy. A full-fledged market financial system would be needed to assure normal functioning of the transmission channel of the monetary system. If a country lacks a developed banking system or financial market then a central bank's capabilities to influence with the help of the interest rate the crediting of the non-financial sector through the banking system liquidity would be limited.

Therefore, when a central bank determines for itself the main target it should, certainly, take into account all the above-mentioned approaches and the assessments of the influence of the chosen target on the production volumes and economic development rates. But, production was influenced in different countries by different factors whose impact must be taken into account. These factors were external as well as domestic. Namely they may be of a primary importance because the transformations that take place in the transition economy affect the pre-existed interrelations between the macroparameters and monetary indicators and lead to the changes in the traditional impact. It is worth mentioning that institutional changes that are required for the inflation targeting regime facilitate an improvement of the macroenvironment and increase efficiency of whatever monetary policy as they make it possible to use another, mainly, market channels of influencing economy by increasing efficiency of market rather than administrative monetary instruments.

Monetary policy activization with a view to stimulating economic growth requires determination of limits and consequences of the impact of such activization on the economy, mainly, on the dynamics of production and prices growth rates. The capabilities of the monetary policy in the creation of favourable conditions for the economic growth would be efficiently implemented only in the system of measures that presumes coordination of the monetary policy solutions with the actions in the other areas of the economic policy. Theoretically it is sufficiently grounded that under different regimes the efficiency and importance of monetary and fiscal policy in tackling macroeconomic stability issues would be changed.

A necessity to revise the monetary policy impact on the macroeconomic parameters is caused by the fact that every economy is developing, is continually in the "non-equilibrium" state and the "models" and "regimes" of the economic growth are changed. But, monetary methods of macroeconomic regulation should be considered only as a factor, moreover, not as a single one but having an effect along with the other more or less significant factors promoting economic growth, since the basis of high economic development rates is, mainly, formed by a new technological method of production which is not a long-term factor of economic growth.

Even the availability of a single target such as reduction of inflation does not mean for the central bank that the selected method of its attainment would be "optimal" forever. The worldwide economic conditions are being changed that during the period of economies globalization and mutual financial capital flows bring in new factors that would mean a permanent search for new approaches to the understanding of the reasons of inflation and, consequently, new forms of combating it. The new factors requiring the development of a new paradigm of monetary management and revision of the instrument that have been used may be added to its well-known classical forms: "cost-push inflation", "demand-pull inflation", "imported inflation", "inflationary expectations", and "accumulated inflationary potential". The rapidly growing economies started to make a greater impact on the world inflation at the expense of the additional demand for resources for the investment development, as well as for foodstuffs that was reflected in the world dynamics of prices. Thus, the long-term inflation trend in the national economy may be synchronized with the global inflation to an increasing degree. Although it makes a nonequivalent impact on different countries, such impact is more likely to be stronger on the countries having the highest share of consumption products in the basket and relatively short history of price stabilization.

The foregoing indicates the constantly changing conditions in the countries and increased impact of world processes on the transition economies making the search for optimal monetary policy more complicated. This means that the trends in the world economy make a direct impact on the national economies and vice versa. The Belarusian economy is not an exception and, therefore, it is necessary to take into account in what way the external economic factors influence the rates of its growth. In the conditions of the available access to the international capital markets and the possibilities of the free capital movement certain "abilities" of monetary regimes are being lost. Inflation depends, to a great degree, not only on the policy of the exchange rate, foreign exchange reserves movement, the state of balance of payments and trade balance, but also on the changes in the world prices and capital movement between the countries.

At present, economists note the change in the short-term statistical dependency in the transition economies between the monetary aggregates and inflation. This may confirm that structural reasons, existing imbalances, poor market infrastructure and instruments development, and accumulated inflationary potential have the greatest importance for the inflation in transition economies that limits the efficient impact of monetary instruments on the inflation. The interrelation is decreased, more likely, on the background of the changes in the structure of economy and its institutional characteristics. As the financial market of these countries enjoys development, the influence of the money supply volumes on the inflation and economic growth rates changes because in this environment money supply makes an impact on the dynamics of production not only by way of the direct servicing of the material production sphere, but also through the financial market.

Besides, the registered change in the interrelation between money supply and inflation is explained as well through the another vision of impact on the gap between the potential GDP and actual level of production, that is maximum real production costs, which creates inflationary potential rather than inflation itself.

All the above-mentioned facts evidence the necessity of the further deep analysis of the inflation reasons, understanding of the role and significance of market institutions for the economic development of the country, and ongoing analysis of qualitative changes in the interrelation between the monetary sphere and macroeconomic variables.

Historical experience shows that the movements in the monetary policy target-setting happen in case of the efficiency loss or "impossibility" to attain the stated targets by means of previously used approaches. To some extent it could be explained by the "disruption" or change in the previous interrelations between a big number of indicators.

The critical point of every regime is the issue of stability and soundness of such mechanism, confidence of the economic entities, availability of limits (borders) of its efficient use owing to qualitative changes in the monetary sphere, the economy as a whole, and determination of the moment of switching to a new target.

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