

# Inflation russian economy



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## A dissertation on Multifactoral Regression Analysis of Inflation in Russian Economy

Global inflation has continued to soar in the past years up to date. The global economies are experiencing varying forms of recessions caused by factors like rising demand against low production, credit crunches and chief among is the global oil prices crisis. The vicious cycle of inflation has particularly pervasive impact on developing economies that operate on shoe-string tight budgets based on fiscus circumscribed in crippling debt. The scope and objectives of this dissertation border on exploring the effects of inflation growth with particular case focus on the how global inflation growth has impacted on the emerging market that Pakistan is. The study will present multi-dimensional explorations of the cause-effect scenario around the subject matter and culminate in conclusions derivable from the syntheses and analyses of gathered research data.

### *Chapter 1*

#### *Introduction*

#### *Background of the Study*

Global Inflation has continued to grow in the past years posing varying implications and global economies categorised as developed, developing and underdeveloped. Notably food and fuel prices have been leading the race in the inflation growth that has ushered an unprecedented era of world-wide commodity price boom.

It is widely assumed that macroeconomic conditions have a substantial impact on popular unrest and political instability. High inflation and slow or negative economic growth undermine living standards, especially among the urban poor and middle class, producing dissatisfaction with incumbent governments that may result in demonstrations, strikes, food riots, and other forms of instability. If macroeconomic conditions continue to deteriorate, or if incumbents fail to respond appropriately, this instability may turn violent, perhaps even assuming a revolutionary character. If so, the government may be overthrown, and the survival of the country's political institutions may be threatened.

Adverse macroeconomic conditions have been implicated in the downfall of countless governments and have been cited as primary causes of revolution or regime change in cases like Czarist Russia, Weimar Germany, Allende's Chile, and Somoza's Nicaragua. However, there have also been many cases where governments or regimes have survived periods of macroeconomic decline; and many changes of government or regime have occurred during periods of relative prosperity. Moreover, since political instability can adversely affect macroeconomic conditions by influencing the actions of government policymakers and private economic actors, many situations in which macroeconomic conditions seem to produce instability may, in fact, reflect reverse causality. Consequently, although it is widely believed that macroeconomic conditions affect political instability, the causal relationship between these two sets of factors is not entirely clear. Empirical analyses that clarify the nature of this relationship are therefore quite useful.

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### *Acknowledgements*

This research sets out to examine the dynamics of inflation on an emerging economy that Russia is. Regardless of the researcher's intent to be as comprehensive and extensive as possible in fulfilling the conceptual scope and objectives of the study, the research endeavor will not be exhaustive by any means at all. Findings to be presented here-in can not be taken as gospel representations of the scenarios, concepts and circumstance here-in explored. The substance value of this study will have its own limited contributions to the related and relevant extensive bodies of knowledge.

### *Definition of key terminology*

#### *1. Inflation*

Definitions submitted by various scholars present somewhat concurring and divergent perspectives on the concept of inflation. The broadly accepted definitions of inflation are those that underscore the underlying causes of the rising of prices in their thrust rather than just focusing on the end result of the rising prices without the background and frameworks of the breeding ground for the entirety of the phenomenon of inflation. After presenting a far reaching background outline on the aspect of inflation which takes into cognisance various dimensions of the nature and causes of inflation scholars in Futurecasts online magazine ([www. futurecasts. com](http://www.futurecasts.com)) present the following definitions of inflation.

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“‘Monetary inflation’ is simply the artificial expansion of the money supply, and is historically the primary engine of inflation. It pleasantly enables demand to increase before any increase is produced in supply.” (www.futurecasts.com)

On the above cited definition the scholars state that “ This ‘ cause’ is so dominant that it should be the first thing that comes to mind when referring to “ inflation” during peacetime. (Opcit)

The scholars go beyond the surface and provide further extensions on the perceptions of the inflation concept. On price inflation scholars give the following definition.

“‘ Price inflation’ is the market’s natural unpleasant ‘ deflationary’ reaction to monetary inflation. By reducing the purchasing power of all currency in circulation, and by reducing the purchasing power of credit based on assets, rising prices powerfully if somewhat belatedly counteract the pleasant artificial increase in purchasing power that is the purpose of monetary inflation. Price inflation tends to reduce demand and increase supply.” (Opcit)

On the above cited definition the scholars further highlight that the pleasant delay between the cause (monetary inflation) and this effect (price inflation) can be extended by expending financial reserves of gold and hard currencies to support the value of the inflated money.

The resource used above is especially useful in the dissections and classifications of the inflation concept offered in the given definitions. The

scholars have also gone a step further to present what they term real inflations. On real inflation the scholars present this definition.

“‘ Real inflation’ is the rate at which inflationary causes would impact price levels if all inflationary causes were considered and the time gap were eliminated. Since precise measurement is impossible, this is essentially an evaluative process, producing a figure or range of figures that constitute fairly inexact estimates.” (Opcit)

The present nuances give a foundational conceptual platform for further explorations on the subject focus of this study which aims to bring to light the effects of the global inflation growth in developing economies.

### *Measures of Inflation*

#### *The Consumer Price Index*

In finance and economics The Consumer Price Index (CPI) is a measure of the average change in prices over time in a market basket of goods and services. CPI thus becomes a measure of the average price of consumer goods and services purchased by households. The calculation of the CPI is normally the task of the national statistical agencies. In the CPI measuring formulae the percent change in the CPI is a measure of inflation. The CPI is normally used to regulate aspects such as wages, salaries and pensions for the effects of inflation.

#### *The Wholesale Price Index (WPI) Older Term for Producer Price Index (PPI)*

The wholesale Price index or Product Price Index is a government statistical agencies calculated index of wholesale prices, indicative of inflation in an economy. WPI is thus a relative measure of average change in price of a basket of representative goods and services sold by manufacturers and producers in the wholesale market. The mainstream financial definitions of the WPI here present a family of three indices (finished goods, intermediate goods, and raw materials or crude commodities); it is used as an indicator of rate of inflation or deflation. The WPI varies from the consumer Price Index (CPI) which simply measures price changes from the consumer's perspective; PPI on the other dimension measures them from the seller's perspective.

### *The Post Soviet Economy*

During the immediate post-Soviet period, Russia's transition from the Soviet's central planned economy from 1991 to 1998 was laborious. Cooper (2008) asserts, " In an economic perspective, said transition years under the tutelage of President Boris Yeltsin's government was a period of economic bedlam during this time, Russia lost thirty percent (30%) of its gross domestic product or GDP. The decline was comparable to the United State's Great Depression during the 1930s." Following the collapse of Ruble high inflation rates in 1992 and 1993 dealt a heavy blow on the Russian citizens' savings.

" While well to do individuals invested in hard assets such as art works, foreign currencies and real estate to secure themselves against inflation" (Cooper Opcit)

Reviewed statistics show that disposable income of the general populace was reduced to 25% between 1993 to 1999, forcing the Russian government to issue a new currency, where 1 new ruble is equivalent to 1, 000 old rubles “ Similarly, foreign investments were inadequate to the stupendous financial and economic requisite of Russia Consequently, Russia’s foreign debt soared to \$150 billion between 1992 to 1999 - the primary reason for this was:” (Cooper 2008). In Cooper’s outline Russia answered the foreign debts incurred by the entire former Soviet Union as pre-arranged with the former Soviet states; not to mention the country’s own foreign obligations that were incurred since “ the collapsed of the Soviet Union (Cooper 2008: 10).” These financial dilemmas were in part results of the following (Cooper 2008: 10):

1. The economic system of the government which emphasised heavy industrial production and manufacturing expenditures that affected the other sectors such as the agriculture, services and consumer industries.
2. Russia’s central planned economy also run large production facilities that were evidenced to be: 1) inefficient; 2) not very flexible to change; 3) often produces products with poor quality; and 4) not competitive in world markets.
3. Poor conception and execution of economic policies by the Yeltsin government. The authorities were unable to curb expenses amidst massive subsidies for the whole industry and the population, raking up large budget deficits with a 9. 8% of GDP compelling the government to finance debts at high interest rates.



During the same period, the government implemented extreme macroeconomic strategies as a part of the economic reform program guided by the Prime Minister Yegor Gaidar (Cooper 2008: 4). Economists observed said strategies to have paved the way to inflation and economic crises since prices of goods, other produce and services were enforced at the early stage of the reform process. Simultaneously, the post-Soviet transition also saw the privatisation of state owned production facilities including “ the loans for shared program (Cooper, 2008). To be able to gain a stable financial footing, the Russian government in 1995 auctioned shares to local banks. Said shares were from the 29 most lucrative firms held by the government, which includes major oil companies and mineral producers. The auctioned shares were used by the banks as collaterals for government issued loans that were mainly intended to alleviate rising budget deficits. The auctions were controlled by the “ oligarchs” who obtained the shares at a very low market value. The oligarchs were able to keep their shares when the government was unable to pay the loans back (Cooper 2008: 4).

In 1998, Russia’s economic problems came to its worst, which necessitated a reform on Russian economic policies. The value of the ruble sank, domestic loans were not paid, and interest rates soared, the Russian stock market declined along with the gold reserves and real GDP. This was due to the accumulation of short termed debts by the Russian government, which could have been kept at bay as long as it could keep the loans up to date. However, other external factors in the form of world oil prices and other commodities, that is the bulk of foreign currency earnings of the government dropped; putting pressure on the foreign currency reserves, making it

difficult to pay off the debts and prevent the decline of the ruble's value.

Moreover, Russia's economic setback is also caused by its lousy economic policy and structure that failed to " institute tax reforms, property rights and bankruptcy laws and procedures.

### *Russia's Economic Policy*

Economists analyse foreign economic policies on a variety of approaches.

According to Robert Baldwin, there are four major players that are considered in the determination of a country's international economic policies, to wit:

- Individual Citizens
- Common Interest Groups
- The Domestic Government
- Foreign Governments and Foreign Groups

In Russia's case, there are different players involved in determining the Russian foreign policy which are as follows:

- The politicians headed by German Gref - Minister of Economic Development and Trade, the major driving force in accelerating Russian WTO accession.
- The Finance Ministry that established the Stabilisation Fund, which constantly augments foreign exchange reserves and promotes lesser dependence on foreign lending institutions.
- The Ministry of Foreign Relations

- The oligarchs

This is due to the historical legacy of the Soviet Union and the present development of institutions in Russia. Despite the recent booming foreign trade of Russia and its economic revival a closer look at the composition of foreign trade shows that Russia is very dependant on the situation in the world energy markets and the major parts of its economic successes is attributed to high world prices for its exports, oil being one of them. As a result, capital flight and low investment rates had a negative impact on the results of foreign trade. Another factor to be considered is the low competitiveness of Russian industrial goods at the world market, which cannot be supported by the state since it can only be substantiated by giving deference on market values and abiding by set standardize policies and regulations. The state's aim must be to improve competitiveness and rules, which were laid out in the first place must not exempt a chosen few.

The difficulties of having a transition from a centralised plan economy to an open economy should involve active participation, but for Russia the means and functions with regards to the participation were defined clearly. The authenticity of the State's institutions has decline during the Soviet period, and there was no borders and limits with regards to its participation or involvement in the economy. The feasibility of operating a smooth economy must entail efficient civil service, incorrupt courts of law and a credible law enforcement system, which unfortunately is not present within Russia as of today. Law enforcement in Russia is unreliable and the backbone of any law that regulates economic life and economic decisions is the enforcement of law through the courts of law which should be upheld. In such a situation the

expansion of the state economic influence is inefficient and decrepit (Cooper 2008: 125-126).

Furthermore, opening or internationalizing the economy would reduce the Russian government's control of the economy. Coming from an authoritarian form of government and society during the Soviet era, the government would not tolerate the possibility of being unable to directly control the economy which is triggered by uncontrollable factors of the global market. A more diversified kind of policy is required in order to enter the world market, which means losing control for the government.

Russia should as well consider supporting their human force and the factors that have a direct link to them, like education, health care, housing, infrastructure and stable democracy. By advocating for these five factors it could possess a competitive advantage in the production side of its economic sector. Deteriorating education standards and scarce investments generally undermine avenues to increase labour productivity and efficiency. Russia's major weakness in the competitive arena lies profoundly on its poorly functioning public sector. As seen from the preceding statements, the Russian government or current regime must consider a wide array of reforms and must become an actual partner in the changes it seeks, and not as a tool for any personal vested interest or the master of a recent powerful sovereign state (Cooper 2008: 128).

### *Russian Recent Economic Trends*

Despite the economic crisis, Russia strove to make reforms on its devastated economy by abandoning the centrally planned economic system and

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initiated market prices for most goods and services. Having accomplished this, the Russian ruble became exchangeable for trade transactions, penning its economy to foreign trade and investments (Cooper 2008, 10).

After the transition period, the Russian economy has grown and improved since 1999. This brought a better standard of living for the average Russian citizen and economic stability in contrast to the past years where the country's economy has been in turmoil (Cooper 2008: 10). Russia's main income comes from the production and export of oil, gas and other natural resources. Experts predict that the Russian economy will continue to strengthen, while others say that its economic prospects are risky. Needless to say, many European countries and former Soviet states rely on Russia for natural gas. Presently, Russia is an essential market and an important supplier of raw materials. While facing many possible economic roadblocks, how President Dmitry Medvedev's government perform remains to be seen (Cooper 2008)

### *Defining Inflation and Determining the Factors that Causes It*

Inflation is generally a term used to indicate a general rise on the price levels of goods and services. There are four (4) main types of inflation, namely (Riley 2006: 4-7):

- Demand Pull or Excess Demand Inflation - this is the most important and common kind of inflation that occurs when the total demand for consumer goods and services exceeds the availability of supply. Hence, when demand is greater, the natural tendency would be for prices to rise or increase.

The demand-pull inflation could be attributed to the following factors:

- a. Depreciation of exchange rate which increases the price and reduces the prices of exports.
- b. Higher demand from a fiscal stimulus by reducing direct or indirect taxation on government spending. If taxes are lowered, consumers will have more disposable income or money to spend with, and this would cause demand for products and services to rise.
- c. Monetary stimulus to the economy could cause interest rates to decrease which may induce an increase in the demands for loan.
- d. Faster economic growth in other countries heightens the demand for exports of products overseas that allows extra finances for income and expenses within a country's financial circulation. This situation affects the economic cycles of other countries because the economic position of a country is dependent on others.

2. Cost-Push Inflation - costs of production or manufacturing rises due to a variety of reasons, forcing prices of finished goods and services to increase. This is usually due to the rise in wages in excess of any profit in labour production that raises unit costs production and raises prices. This type of inflation is less common than the demand-pull, but can occur independently as well as in conjunction with it.

On the other hand factors that cause cost-push inflation are:

- a. Component Costs - an increase in the price of minor components for the manufacturing or production process would naturally entail a rise of prices for the finish product or service.
  - b. Rising Labour Costs - is caused by increases in salaries and wages. This happens when unemployment is low and there is a great demand for skilled workers. The demand necessitates employees to call for a higher income or pay.
  - c. Higher Indirect Taxes Imposed by the Government - Value added taxes are usually imposed by governments on producers goods like alcohol and cigarettes. The ceiling of the prices for such products depends on the law of supply and demand. Hence, in order to lighten the burden of paying taxes, suppliers and producers alike pass on said taxes to the consumers.
3. Pricing Power Inflation or Administered Price Inflation - this generally happens when businesses decide to raise prices in order to have an increase in profit. This situation happens when the economy is in boom and the sales are strong. This is also referred to as oligopolistic inflation, since oligopolies have the power to determine their own prices and raise them at the right opportunity. Oligopolistic companies usually raise their prices in order to gain larger profits. Although other firms from the industry follow suit in raising their prices, said oligopolistic companies do not suffer much from the competition since they generally take the lead.
4. Sectoral Inflation - this type of inflation occurs whenever any of the three aforementioned kind of inflation occurs within a certain or particular sector of

the economy. Thus, it affects the entire economy forcing prices to rise, though it just originated from one sector.

To reign in demand-pull inflation a sufficiently aggressive macroeconomic policy should be enforced by: tight monetary and fiscal policies to hedge the excess demand. Tight money and high interest rates to limit borrowings and slow down the increase in money supply. Alongside with this is the running of a government budget surplus to reduce incomes and purchasing power. These measures if employed vigorously could stop this type of inflation.

As for the cost push inflation, the possibility of restraining desirable wage increase poses as a problem and if this is not implemented the wage increase usually exceeds the gains of labour productivity. For oligopolistic inflation, oligopolistic companies are unlikely to be price competitive with each other, so the way to contain price increase is to allow the entry of imported goods to increase competition on prices and be able to keep a check on the general rise of market prices.

Several types of inflation can all work at the same time. The term wage-price spiral is a situation where the inflation originates from a demand pull scenario. Labour demands stimulate wage increases to catch up to the rising cost of living, to further increase income and which adds more demand-pull. In cases like this, oligopolies take advantage of raising the prices of their products and services. When any of these aspects touch key sectors of the economy, inflation could further be fuelled.

This last type of inflation is termed as hyperinflation or run-away inflation. The normal tendencies in a hyperinflation is that prices of goods rises so fast

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that when laborers or employees get paid, they quit work and rush to the stores to buy things needed before prices increase further. Some countries that are at the extreme of inflation have to renounce their current currencies and start with new ones that are to be issued sparingly in order to staunch the progress of inflation.

The risk of having hyperinflation varies from country to country and is on a case-to-case basis although slow inflation of about 3% yearly does not pose as an economic threat, effective economic strategies should be adhered to keep inflation from creeping upwards from that rate. Inflation is considered to be a lifetime scenario that varies in degrees of seriousness. People who save for retirement will eventually find out that the purchasing power of their savings has been reduced at 3% annually.

Essentially, the effects of surviving inflation depend on administered economic policies which involve ethical judgment.

## *Chapter 2*

### *Literature Review*

This study is not being conducted in vacuum. The study belongs to a broad theoretical, conceptual and research frameworks set by forerunning scholars, professional and others who have contributed significantly to the themes akin to the objectives and scope of the dissertation. In cognisance of previous contributions made on the core themes of this study , the completion of this study has entailed the broad and in some cases deep consultations and review of related and relevant literature on the subjects of

inflation, economics and particularly the effects of global inflation growth on emerging economies (Russia) among other issues. This component of the study therefore presents references of sources reviewed whilst also outlining a sketch of the influence of the sources presented in helping the broadening of the understanding of key and core thematic aspects of the issues under probe.

### *Regression Analysis literature review*

Doucouliagos, Chris (2006), Stanley, T. D. Jarrell, Stephen B., *Meta- as the Socio- of Economic Research*

This resource explores meta-regression analysis (MRA) indicating that the concept provides an empirical framework through which disparate economic research results can be integrated. The scholars in the source assert that the analysis concept can be used to filter out likely publication selection bias as well as explain the wide variation using socio-economic and econometric explanatory variables. " MRA can empirically model and test socio-economic theories about economics research. Here, we make two strong claims: socio-economic MRAs, broadly conceived, explain much of the excess variation routinely found in empirical economics research; whereas, any other type of literature review (or summary) is biased." (Opcit)

Richard A. Berk, (2004), *Regression Analysis: A Constructive Critique* , Sage Publications

The resource presents a critique of the regression analysis concept as evaluation and forecasting conceptual framework. In the resource regression

analysis is defined as a technique used for the modeling and analysis of numerical data consisting of values of a dependent variable (response variable) and of one or more independent variables (explanatory variables). According to the explanations given in the source, “ The dependent variable in the *regression equation* is modeled as a function of the independent variables, corresponding parameters (“ constants”), and an *error term* . The error term is treated as a *random variable* . It represents unexplained variation in the dependent variable”. (Opcit) The resource has been particularly helpful in the course of this study for expounding understanding around the conceptual tenets of regression analysis.

David A. Freedman, *Statistical Models: Theory and Practice* , Cambridge University Press (2005)

The resource above provides valuable concepts around the application of regression analysis model in forecasting. The resource state that regression can be used for prediction, inference, and hypothesis testing as well as modeling of casual relationships. The source outlines that uses of regression rely heavily on the underlying assumptions being satisfied, “ Regression analysis has been criticized as being misused for these purposes in many cases where the appropriate assumptions cannot be verified to hold. One factor contributing to the misuse of regression is that it can take considerably more skill to critique a model than to fit a model.” (Opcit)

*Federal Bureau of Statistics of Russia*

(<http://popindex.princeton.edu/browse/v63/n3/s.html>)

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The Federal Bureau of Statistics (FBS) is an attached department of Statistics Division, is Russia's official statistical organization. According to the Organisation's profiling, the entity assists and encourages informed decision-making, research and discussion within governments and the community, by providing a high quality, objective and responsive national statistical service. FBS compiles statistics from many sources and produces global updates, including the Statistical Yearbook, Russia Statistics Handbook and yearbooks in specialized fields of statistics.

The FBS has been valuable particularly for this study by providing valuable data on the various economic aspects of the Russian economy.

Upon providing various measures of inflation together with the inflation causes for different period leading up to the 2008, the resource has also shed significant light on the effects of the global inflation on the emerging economy that Russia is.

Paweł Bożyk (2006), " Newly Industrialized Countries", Globalization and the Transformation of Foreign Economic Policy, Ashgate Publishing, Ltd

The above resource has provided valuable insights into the dynamics of the differences between developed and developing countries. The source has shaped the understanding of the Russia's economic facets in relation to its classification as a developing country.

Mauro F. Guillén (2003). " Multinationals, Ideology, and Organized Labor", The Limits of Convergence, Princeton University Press

The resource offers eye opening insights on different approaches the companies, multinationals in particular take in accordance to an economy's level of development. The source presents comprehensive dynamics on the aspects of labour and how companies fare in inflation trends of emerging and developed economies.

David Waugh (2000), " Manufacturing industries (chapter 19), World development (chapter 22)", Geography, An Integrated Approach, Nelson Thornes Ltd., 563, 576-579, 633, and 640

This resource explores stages of economic development highlighting dynamics and aspects of the economic and socio-political features that characterise every developmental stage. The resource is particularly useful the understanding of the classification of world economies as developed, developing and under-developing in the context of the intensity of industrialisation.

N. Gregory Mankiw, (4th Edition 2007), Principles of Economics

The resource has furnished the explorations in this study with core economics concept on the subjects of inflation and related themes in the fiscus domains. The resource has significantly helped the locations of this study in the relevant economics conceptual and theoretical frameworks.

IMF Emerging and Developing Economies List, (2008), World Economic Outlook Database,

The International Monetary Fund IMF goes beyond its functionalities as a funding organisation. The entity is respected research institute and the <https://assignbuster.com/inflation-russian-economy/>

above resource has been especially useful in providing core economic and financial explorations of developing or emerging economies which Russia (the focus of this study) is part of.

Jan Joost Teunissen and Age Akkerman (eds.) (2005), *Helping the Poor? The IMF and Low-Income Countries*, FONDAD

The above resource takes a deeper thrust into the economic dynamics of poor countries and the developing countries. This resource has unearthed some valuable nuances on the effects of global inflation on emerging economies like Russia. The resource has a comprehensive take on the themes of poverty that dominate developing and underdeveloped countries.

Axel (2002), *The Development and Implementation of IMF and World Bank*