Savings and Inflation Using the Example of Russia in 1992

BLINOV, Sergey

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Sergey Blinov[1]

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Abstract

Savings are a huge boon for the economy. This means both growth today and prospects for growth tomorrow. This is both an investment resource and a medicine for inflation. However, mistakes made in managing the savings by economic authorities, may turn everything upside down and then the savings become a cause of inflation and many other economic woes. This is exactly what happened in the far-off 1992 in Russia. Two approaches: reliable tools and advantages of the bond type form of savings would enable Russia to quickly create a significant stock of «long» money and increase the GDP and, at the same time, significantly reduce inflation.

Key words: Savings, Inflation, Shock Therapy, Transitional Economies, Russia

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[1] E-mail: senib2005@yandex.ru or blinov@kamaz.org . Other publications by the author are obtainable from the web site of the «Expert» Magazine http://expert.ru/dossier/author/sergej-blinov/ (in Russian) and from web site of working papers of Munich University https://mpra.ub.uni-muenchen.de/cgi/stats/report/authors/bf480d57955185746d0334cceeb14857/ (both in Russian and in English)

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SAVINGS AS A BOON

It is not that all the money that people earn is spent. Desire to have savings «for a rainy day» since times immemorial has been human's second nature. It all started from stocking up on food back in primeval households. But since humankind invented money, a portion of this stock has been set aside in cash form[2].

Availability or unavailability of savings and even the process of creating them (amassing them) per se exerts a huge influence on the state of economy in any country. Let us consider how savings can exercise a positive influence on the economy.

SAVINGS AS MEDICINE FOR INFLATION

Money supply may grow without escalation of inflation (Blinov, 2015b). It may appear to be a paradox. Indeed, how can this be possible?

It is often thought that the quantity of money (inclusive of its circulation speed) cannot exceed the sum of the goods prices, otherwise there will be inflation. However, this idea does not consider all the properties of money. Money is known to be not just a means of exchange but also a means of conservation or saving. And in order for growth in the quantity of money not to lead to inflation, sometimes it is enough for this money not to be spent but to be saved.

No inflation is caused if all this money, «surplus» money from the perspective of servicing the goods turnover (in other words – «money which is not backed up» by the mass of goods), is saved rather than spent.

Immediately the picture springs to mind where an employee, after getting a 20% pay rise, does not rush to the store to spend his money as soon as possible and decides, instead, set by this «rise» every month on his bank account. And no «anticipated» price hike (inflation) happened.

There can be many many reasons to save money. Here are a few examples:

- Desire to have «money set by «for a rainy day» (in the case of illness, for retirement, etc.)
- Desire to save towards some big purchase for the future (for an apartment, a house, a car)
- Desire to save for your children's future (education, wedding, a home)

[2] As noted by **Turgot** more than two hundred years ago: «The more money came into general use, the more each person, while giving himself up entirely to agriculture or some craft chosen by him, was able to get rid of all the worries about satisfying his other needs and think only of acquiring as much money as possible from sale of his products or by his work, in the full confidence that for this money he could obtain all the other things: so, use of money helped expedite social progress tremendously»

- Desire to make a buck, to put it bluntly. You can put your money in a bank and get interest on this deposit. While when deflation hits, for example, even merely keeping money there without any interest becomes advantageous (goods are getting cheaper and it would make more sense to buy them later rather than now)

Sometimes savings have to be made by force of circumstances, for example, because you are just not in a position to spend money or the person who owns money deems it to be unbeneficial. Just picture to yourself a man who is working in an oil or gas field on «shuttle shift basis» behind the Polar Circle. He is unlikely to be spending all the money he makes while he is doing his stint or tour of duty. And the reason for that is obvious: the goods he may be interested in on his jobsite may be either too expensive or even unavailable however trivial it may sound. It may be a matter of the goods transportation to his permanent place of residence being too costly (will anyone be buying furniture behind the Polar Circle to ship it from there to their home in the Moscow Region, for example).

It may well be just for a short period of time, but the money earned by the «shuttle shift worker» do get converted into savings. That is, it is not spent.

If somebody finds this example to be too far-fetched, then other examples of savings can be adduced to which have taken place at the macro-economic level. Thus, for example, during the Second World War, the U.S. economy was vibrantly booming on military orders. People used to make decent money producing ships, aircraft, trucks, foodstuffs for the army. However, the opportunities of spending all this money were rather limited. The matter is that even at the legislative level, the food, luxury goods and other goods markets were restricted. *«… during the war years, there developed an enormous deferred demand. During the war, the U.S.A. was on food rationing, car production and production of many types of domestic appliances were banned, housing construction was restricted. However, people used to get paid regularly and kept it in banks»* (Pankin, 2010)

However, later it is exactly such deferred consumer demand (supported by residents' savings, that is, demand backed up by purchasing power) that played a great positive role in the post-war economic boom in the U.S.A.

GDP GROWTH WHEN SAVINGS ARE GENERATED

Money emission, with growth of savings concomitant to it, directly facilitates growth of the GDP. Let us try to figure out what will happen if the government (in the broad sense of the word, i.e. including the Central Bank) issues a certain volume of additional money, but all this money goes into savings? It may seem surprising to someone but this will cause the GDP to grow, at least, by the amount of money issued.

It is easiest of all to imagine this in a socialist state (for example, in the USSR). Suppose the State Bank has issued an additional 1 bn. Rubles[3], which was used to pay wages to the workers who are building, say, for example, an electric power utility. And at the same time, deposits with the State Bank increased by the same 1 bn. Rubles. For the State Bank everything looks as if «the amount of money that went had been as much as the amount that came». But at the same time, workers produced products which caused the GDP to increase. It must be underlined that the State Bank's obligations to the depositors increased. The amount of the general public's deposits increased, and, hence, their well-being increased.

The example from the socialist system was cited above only to make it easier to visualize. But just as in the socialist economy, growing savings concomitant to emission make the GDP grow in any capitalist economy. Suppose the Russian Central Bank issues and sells the so called Bonds of the Bank of Russia in the amount of 1 trln. Rubles with redemption period of 5 years. That would mean that the owners of this 1 trln. Rubles agreed (for a certain compensation, for example, for interest) to postpone use of this money for 5 years. But the GDP was produced by these owners (when they earned their money). Whereas for the Central Bank such an operation enables it to issue new money in the amount of 1 trln. Rubles without the risk of inflation spiraling out of control. And if the Central Bank goes ahead with such emission, this will result in exactly the same «Soviet» example given above differing in the amount only.

GDP GROWTH WHEN SAVINGS ARE EXPENDED

However, the effect produced by availability of savings is not confined only to GDP growth when savings are generated. It is very important that availability of savings means high potential demand for goods and services. In the example mentioned above, the Americans, working during the war time for defense industry, would spend relatively little on consumption and saved relatively much. And the availability of such savings, after the war, created an enormous growth potential for production of goods and services for these people. Besides, there was no uncontrollable surge of inflation – while in 1949 deflation was rampant.

A good street trader is said to be able always to sell a pair of shoes to a man with a one hundred dollar banknote in his hands who is standing barefoot on a hot sidewalk (or – on a snow bound sidewalk). That means if a person needs something and he has enough money, there will be more than enough individuals wishing to offer him a solution to his problem.

The «shuttle shift worker» from the example above, who has savings generated by his work in the old or gas field, is also a welcome consumer (for producers and sellers) of different goods and services, such as apartments, cars, home appliances and many other things.

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[3] At constant prices

A huge number of people who have considerable savings is «the paradise for traders» (and, hence, also for producers) of goods and services. And, undoubtedly, growth of the general public's savings is conducive to such favorable climate for the economy to develop. Moreover, an «ungodly» thought sneaks up on you: it is precisely the availability of demand that is the most important prerequisite for development of business and investments, which are central to a «good business climate». Moreover, if there is no demand, no other factors can help (for example, no credit interest rates or "institutions" often mentioned in the speeches of certain Russian politicians and economists, etc.).

In other words, GDP grows, when savings are generated. But it also grows when they are spent, and producers begin to manufacture goods and services against deferred demand.

SAVINGS AS AN INVESTMENT RESOURCE OR «LONG» MONEY

Growth of savings has a favorable effect on the economy also because of the fact that they facilitate investments. Many macro-economic models (theories) directly presuppose identity between savings and investments. If savings are long term (for example, as in the case of 5-year bonds of the Bank of Russia), the investments may also be long term. For example, if a depositor puts the money in the bank for 5 year, the bank will then be in a position to offer with greater confidence an investment five year credit facility in this amount to an entrepreneur. Though, there is the problem with early withdrawal of the deposit and we will talk about that below.

The importance of «long» money for the economy is obvious. This is also spoken about by the President of Russia **Vladimir Putin (2012)**. «We need cheap and long money to provide credit facilities for the economy. I request that the government and the Central Bank should think over the mechanisms of solving such problems», — he said in his address to the Federal Assembly in December 2012, having underlined that "long" money is the general public's savings, those of enterprises, pension money, etc.».

SIMPLE NUMERIC EXAMPLE

We have considered above the multiple positive aspects both of the process itself of accumulating savings (GDP grows, while inflation is not caused or, at least, is reined in when there is lack of «goods backup» for the money), and availability of a large volume of savings in the economy (there is a high potential demand for goods and services, there is «long» money available for investments).

Now imagine that you hear someone talk about a country where bank deposits and availability of cash held by the population of this country by several orders of magnitude exceeds the stock of goods in wholesale and retail trade. Moreover, as time goes by, the gap between the indicators only widens. (***Table 1***).

Table 1. Ratio between the general public's cash and stock of goods in the hypothetical country (as at the end of the year, bn. units in local currency.)

Indicator	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Money (cash plus all the bank deposits)	166	181	199	222	255	295
Stock of goods in trade (retail and wholesale) and industry	50	46	42	41	42	36
Stock of goods as percent of money	30,1	25,3	21,3	18,6	16,3	12,1

Out of what we have learnt about the positive properties of savings above, we can say that in this country the state of affairs with savings is just fine.

- Firstly, the process of generating savings is underway (people are willing to «create» the GDP, working for money rather than for goods; inflation is likely to be low or there is no inflation at all).
- Apart from that, a large volume of savings means a high potential demand on the part of the general public. This is «paradise» for the entrepreneur who can offer goods and services to cater for the general public's respective demands.
- And, finally, a large volume of savings means that there is money in the system (and, judging by increase in cash reserves throughout many years, it means «long» money), which can be used as investments.

Doesn't it look like the U.S.A. in certain respects during the years of the Second World War, when goods were in short supply, while the general public's savings were growing and were the prerequisite of the post-war boom? Or is it some other country? As we will see now, the example is by far closer to the Russian economic history.

SAVINGS «THROUGH THE LOOKING GLASS»

One can be surprised as much as one pleases, but the information given earlier in table 1 refers to the USSR. It is set out in the table to the article of the Russian economist **Andrey Illarionov (2013)**. Here is what a piece of this table looks like for 1985-1990 (see ***table 2***). As can be seen, the numbers in it are absolutely the same as cited in table 1 given above.

Table 2. Ratio between the population's cash and stock of goods in Russia (as at the end of the year, bn. Rbls.)

Indicators	1985	1986	1987	1988	1989	1990
Money (cash plus all the bank deposits)	166	181	199	222	255	295
Stock of goods in trade (retail and wholesale) and industry	50	46	42	41	42	36
Stock of goods as percent of money (kopecks' worth of goods stock per 1 Ruble's worth of cash)	30,1	25,3	21,3	18,6	16,3	12,1

Source: A. Illarionov (2013), «State in Debt: How Citizens' Savings Were Destroyed at the Savings Bank of the USSR»

Please get prepared because now we will find ourselves in the economic world, as it were, which can be reached by going «Through the Looking Glass». And there, in this world, things are known to have been reduced to absurdity. Savings in the world «Through the Looking Glass», in the opinion of some economists, are not a boon at all, they are an evil.

This is incredible. Had the situation in the USSR, by the early 1990-s been almost the same (i.e. just as good), as before the post-war economic boom in the USA? Basing ourselves on the example of the USA, we were able to see that it was not so much the cause of inflation as a prerequisite for economic growth. But with the savings being regarded as a boon rather than a scourge.

And here at this point we end up being transported «Through the Looking Glass», i.e. the world where an abundance of large savings is not an opportunity but a challenge instead. As, in the opinion of certain economists, citizens' growing savings had been a bane rather than a boon. Thus, for instance, **Vladimir Nazarov (2013)**, fellow of the Institute of Economic Policy named after Gaidar[4], in an item with a telltale name «Soviet Pyramid: Why Were the USSR Citizens' Bank Deposits a Hoax», cites somewhat different data with respect to the same indicators. However, the tendencies in his data are identical: savings were growing, their «security in goods» was diminishing and in 1990 it also constituted about 13% of cash reserves.

It is just that he put quite a different construction on these data which was that they were far from being a benefit: «*... the Soviet leadership made out as if there had been huge savings, and provided the citizens with an opportunity of periodically buying something at fixed prices.*

[4] Russian Vice-Prime Minister in 1991-1992.

People were able to see that if they were to stand in a line for a very very long time, if they were to secure proper connections, or give the right person a little bribe, they would be able to convert their savings to goods and services. The problem consisted in the fact that if everybody had wished to do it all at the same time, nothing would have come out of it. That was one big pyramid of illusions whereas the Soviet Savings Bank deposits were lying at the foundation of this pyramid».

Apart from that, Mr. Nazarov claims that it is precisely the availability of large savings held by the Soviet citizens that forced **Egor Gaidar**, who was actually at the helm of the economic policy in Russia in late 1991 – early 1992, to steer a political course aimed at doing away with savings. *«… Gaidar's government did not legalize destruction of property; it only liberalized prices, after which it was not Gaidar but the market itself that showed what the Soviet citizens' savings were worth: they were worth exactly as much as one could buy by paying in socialist illusions»*, claims Nazarov.

Egor Gaidar himself writes about the same in his book «Days of Defeats and Victories» (1996): *«Almost since the very beginning of re-structuring (perestoika), from the government's faucet a jet of cash had been spurting forth not exactly uncontrollably generously but, obviously, in excess of the government's capability. Having failed to find a drain, that is necessary goods, this cash would wind up in deposits in the savings banks… And this is exactly what cash overhang is»*.

In the same book he then goes on to say: *«… even today (*the book was published in 1997*), I am still accused of immoral and ruthless policy, which painfully hurt the working people's pockets, of tough measures which led to devaluation of the deposits in the savings banks which were "worthless" as it is …»*.

THE FLIP SIDE OF THE SAVINGS

Why may savings, in one case, be a boon and, in the other, an evil? The very first positive property of the savings, which we discussed at the beginning of the article is to deter inflation in the process of savings growth. We pointed out that if the money earned was not spent and was saved instead, this enabled the Central Bank to issue new money without fearing to cause inflation.

However, if we are to look at this property of the savings from the other perspective, then the reverse conclusion may be made: if savings in a large quantity start being spent, this inevitably would result in a spike of inflation. Remember our example in which the worker would regularly take a portion of his wages to the bank? It is just enough to imagine that, the other way around, all the holders of deposits, for some reason, would suddenly run to the bank to withdraw these deposits and then spend the money withdrawn from the bank. There is no doubt that this would lead to a surge of inflation.

ARE THE SAVINGS A BOON OR A BANE? WHAT IS THE RIGHT ANSWER?

So which of the two answers is true? Is it true that savings are a benefit for the economy? Or is the truth in the words said by Gaidar and his followers to the effect that savings were «money overhang» and a problem for the economy?

We mentioned above that the President of Russia had set the target to provide the economy with «long» money. In addition, it had been directly indicated that citizens' savings, including pension savings, were a very important source of such «long» money. So is it that the President wishes ill for the Russian economy? As according to Gaidar's, Nazarov's and some others' terminology, the President was calling for «money overhang» to be created, which, (again according to the above mentioned economists) has a bad ending?

This question is not only interesting, but to this date it has been worrying many citizens (some of them are now no more), who, during the time of «shock therapy», lost their deposits as a result of sharp devaluation of such deposits. This is exactly the question which we will attempt to address and elucidate.

HOW TO MAKE THE SAVINGS A BOON – MAIN APPROACHES

It is hugely important to understand what reasons can drive people to avoid saving money? And what is the reason why the people begin to get rid of the savings that they have? And the reason is simple enough, it is their fear to lose their savings. The dearest that a person has is his or her time. While deposits are kind of «concentrated or condensed time». On the one hand, these are the years of one's life spent to earn these savings. On the other hand, these are the years of one's life which one could live in the future thanks to his or her savings, for example, on pension in retirement. This is exactly why, if the person senses that his or her (many years') savings are under threat, he or she will make an attempt to rescue them.

HOW CAN YOU BOOST PEOPLE'S CONFIDENCE IN THEIR SAVINGS

There can be a great many reasons for people to fear for their savings. Let us consider some of the possible risks:

1. **Risk of losing the savings as a result of the bank going bankrupt.** Before putting in place a system for insurance of deposits (for example, during the time of the Great Depression in the USA) this was one of the most common reasons for the so called «runs on the banks», often leading to their bankruptcy. Loss of savings, if this risk materializes, results in deflation more often than in inflation, with the consequences for

the economy being just as deleterious. **Solution**: setting up a system to guarantee repayment of deposits. In the USA, such a system has been in existence since 1933, in Russia it has been implemented by the Agency for Insurance of Deposits.

2. **<u>Risk of losing savings due to inflation.</u>** If interest on the deposit is lower than the level of inflation, this also causes, firstly, the money to be withdrawn from the bank accounts, and, secondly, results in attempts to acquire something as soon as possible using this money (and using available cash reserves). Depending on the situation, goods, gold, foreign exchange, real estate and other assets can be purchased. **Solution**: system which guarantees protection from inflation. For example, inflation protected securities, such as TIPS in the USA. Recently the Russian Finance Ministry has also been offering securities whose nominal value is indexed by the level of inflation.
3. **<u>Risk of losing savings due to decline in exchange rate.</u>** If the foreign exchange in which savings are kept, loses its value (during the times of the «gold standard» - in relation to gold, now – in relation to other currencies), then it is akin to the case of inflation considered above. Usually the people, in an attempt to avoid it, try to quickly «convert» from the local currency to other ones, or initially keep a portion of money in «reliable» currencies. **Solution** on the part of the economic authorities could be issuance of securities whose nominal value changes according to fluctuations of the exchange rate (similar to inflation protected securities).

Let us note that all the risks described above have one property in common. People's spontaneous attempts to retain their savings only make things worse.

- Even a quite sound and secure bank, once rumors about its problems start going around, can experience (and sometimes fail to withstand) «a run of depositors». Everyone who has withdrawn his money from the bank «just in case», makes the bank's position still more unstable and the forecast of its «instability» comes to fruition (like self-fulfilling forecast). For example, at the end of 2014, certain difficulties were experienced even by Sberbank of Russia, which was mentioned in his report to the President by the Head of Sberbank **Herman Gref**.
- People's attempts to save their money from inflation by purchasing goods only pushes the prices up for the very same goods. In other words, in an attempt to save themselves from inflation, people cause the very same inflation to spiral out of control. The most blatant example of such a situation is the «shock therapy» orchestrated by Gaidar. That one will be discussed in greater detail below.
- Just the same, if people, in a bid to protect themselves from the weakening local currency, get rid of it, by buying foreign exchange, this would only cause further weakening of the local currency and a new wave of panic. A case in point was the

«smooth devaluation» of the Ruble in 2014, which ended in the sharp decline in the Ruble exchange rate (Blinov, 2015a)

This is precisely why it is very important that people should not be left to fend for themselves and should not act chaotically. The government, including the Central Bank, can and must play a stabilizing role in such situations.

For example, one can only welcome the increase in the amount of the guarantee for the general public's bank deposits from 700 thnd. Rubles to 1.4 mn. Rubles. Also the Bank of Russia's denial of consent to deterioration of the terms and conditions for guarantee of bank deposits proposed by Herman Gref, Head of Sberbank, appears to be absolutely correct. This was quite aptly commented on by the Head of the Central Bank **Elvira Nabiullina** (2015) during her report to the State Duma on June 16-th 2015: *«The issues of economizing the funds of the Agency for Insurance of Deposits should not be solved at the expense of undermining the trust for the banking system, at the expense of the banking system's stability. In our opinion, implementation of the proposals which have been tabled may lead to the lowering of the trust for the banking system. For example, let me remind you that the so called deductible whose introduction is under discussion is something that we had just in 2008. During the difficult period, it was abandoned and it would be odd to re-introduce it now again. Now we are having an inflow of deposits into the banks, it is very important for us to maintain this tendency and avoid taking decisions which might undermine this trust»*

At the same time, in the area of protection from inflation or protection from decline in the exchange rates, the efforts exerted by the Central Bank so far have been obviously insufficient. And for this purpose, it only takes to organize issuance of relevant bonds of the Russian Bank:

- **«Anti-Inflation» Bonds of the Bank of Russia**, whose nominal value is indexed by the level of consumer inflation, as protection of savings against inflation (equivalent of the above mentioned TIPS). Apart from compensation for inflation, these Bonds of the Bank of Russia may involve a small interest revenue (0.5-1%).
- **«Anti-Devaluation» Bonds of the Bank of Russia**, whose nominal value is pegged to the official exchange rate of different currencies (or «currency baskets»), as protection against devaluation of the Ruble.

Issuance and active sales (if necessary, with discount) of such bonds during the difficult periods will make the situation stable. During the times of inflation surges, instead of the Rubles overflowing the goods market, the Rubles will be flowing into (useful for the economy) savings of the «Anti-Inflation» Bonds of the Bank of Russia. While at the time of foreign exchange crises, instead of pressure brought to bear on the foreign exchange market, Rubles will be conserved in the «anti-devaluation» bonds of the Bank of Russia.

LONG TERM DEPOSITS VS LONG TERM BONDS

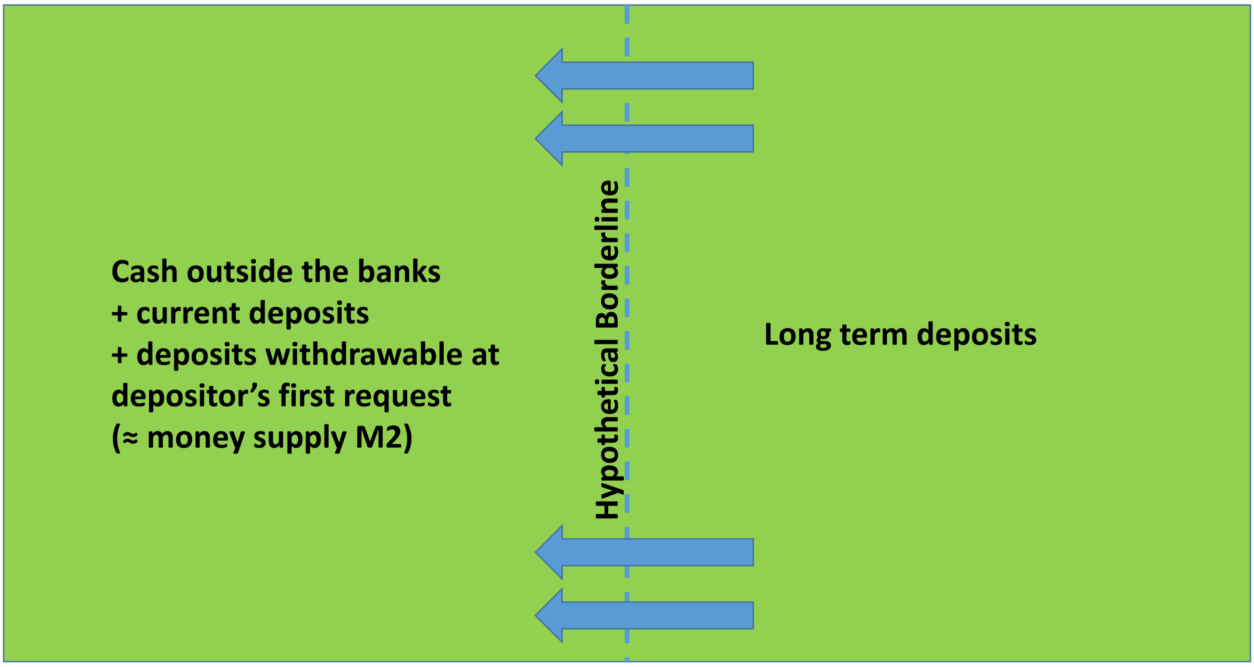
Seemingly two different forms of savings, the long term deposits and long term bonds have many things in common.

- Both the former and the latter are a saving (a reserve, an investment).
- Both investments presuppose investor's revenue. In one case this is interest on the deposit, in the other case it is coupon revenue (payable regularly, for example, once a quarter) and/or revenues, obtained at the time that the bond is acquired in the form of discount.
- Both are an obligation vis-à-vis the investor (on the part of the bank in the case of deposit, for example, or on the part of the state in the case of government bonds). In other words, it is a debt.

However, these two types of savings differ a great deal from the point of view of influence on inflation, foreign exchange rates and security of savings.

<u>**Savings in the form of long term deposits**</u> can very easily «flow» into regular money and (in certain cases) thus influence prices rises, i.e. make inflation spiral out of control. ***Diagram 1*** shows that the borderline between long term deposits and «ordinary» money supply is very blurred. Holder of a long term deposit can, almost at any moment, take out his money (it may well be with certain losses of interest on the deposit) and start spending it.

Diagram 1. The borderline between the long term deposits and «ordinary» money supply is very blurred. In the case of panic, deposits can quickly convert into cash or into current deposits (blue arrows), bringing pressure to bear on the prices, foreign exchange rates, etc.



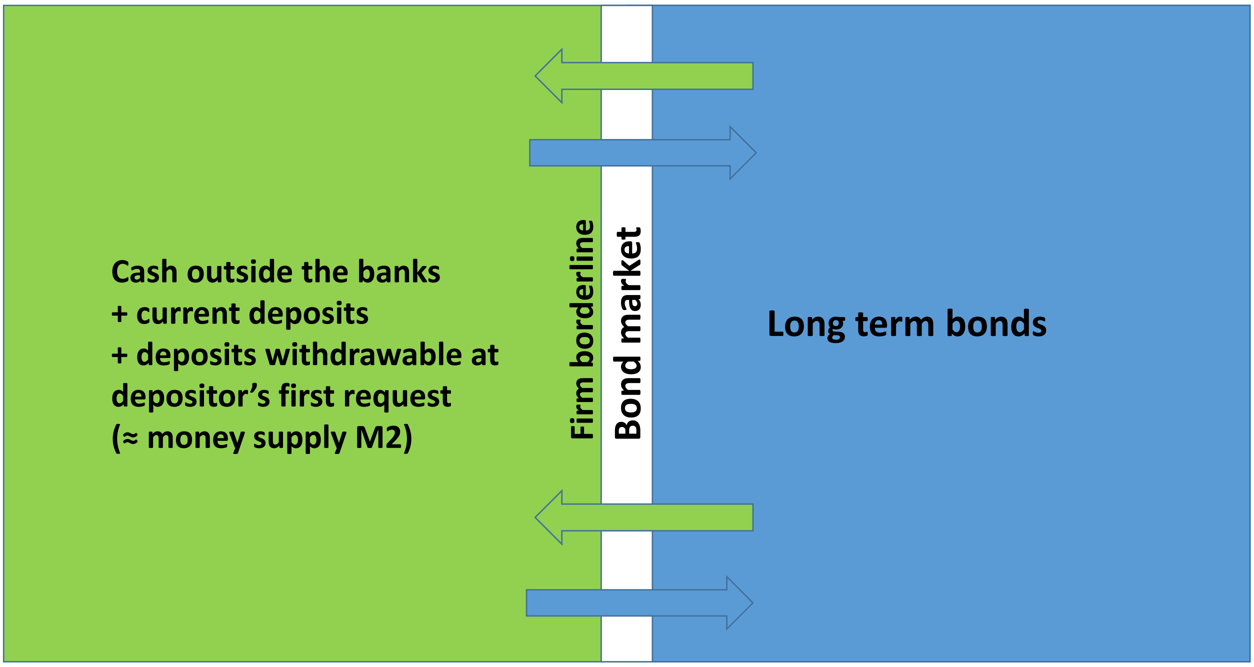
Source: diagram developed by the author.

If as a result of this, inflation intensifies, more and more holders of long term deposits will begin acting exactly in the same manner. The process will become «self supporting».

Of course, there is hope that holders of long term deposits do not yield to panic (or temptation) to spend their savings quickly. In some ways it looks like hopes of a mother who has many children who hopes against hope that her husband (a drunk and a gambler) can reliably save their family money, or at least the wages he got for the month. We shall revert to this metaphor later.

Savings in the form of bonds cannot lead to «self supporting» inflation. This property of the bonds is worth discussing in greater detail (***diagram 2***).

Diagram 2. When a bond is sold, the amount of money in the system does not increase. A bond, as an «obligation not to spend cash», is transferred from one market player to another. In the case of panic, demand for cash (green zone) increases, which results in the strengthening of the currency and price stabilization.



Source: diagram developed by the author.

The diagram shows that, actually, ***the bond holder, for a definite period of time, undertakes the obligation not to spend money***. Moreover, for the period of time until redemption of the bond, he is deprived of this money, having received a security in exchange. All this is done for a certain fee in the form of revenue on the bond. In other words, for a certain period of time, the holder of «savings in the form of a bond» cannot spend his money – it is just that he does not have this money. Remember our metaphor with the wife of a drunk and gambler? Just imagine that she keeps all the family savings in her custody and on pay day she takes it from her husband at once. Her husband gets no chance to drink or to gamble this money away.

Of course, in the case of need (if money is needed urgently) the bond holder is in a position to sell it in the market. But (mind you! – and this is what the whole «trick» is about) this does not increase «the current money supply» in the system, since actually the obligation not to spend money simply passes from the old bond holder to the new one. Metaphorically speaking, for the person to be able to pass from the blue area in diagram 2 into the green one, he has to find another person from the green area who agrees to pass into the blue one instead of him[5].

[5] It is clear that we are talking about amounts of money rather than the number of people.

Another metaphor: if all the tickets to the concert (performance, etc.) you are interested in, have sold out, you can try, right before the concert, to find a person who has these tickets and who will agree (maybe, for a fee) to surrender the tickets to you and not to go to the concert.

Let us emphasize that the «bonds-money» system is self-regulating. Bond holders and holders of money, making deals in the market, set the prices of the bonds. And this automatically establishes their profitability and hence attractiveness.

If there happens to be very many bond holders in the market, this causes prices for these bonds to drop down. But this price decline makes acquisition of the bonds more profitable. As a result, with all other conditions being equal, among «holders of money» there will be more people wishing to buy such bonds.

Let us consider an example with securities. For the sake of simplicity let us consider them absolutely reliable[6], so that we are not diverted by the assessment of the probability of failure to repay the debt (default). If you buy for 90 Rubles a bond with nominal value of 100 Rubles to be redeemed in 1 year, then a year later you will receive a revenue in the amount of 11.1% per annum[7].If the bond holders urgently need the money and sell them, for example, for 80 Rubles, you will be then getting as much as 25% per annum!

Higher yield attracts more people desirous to buy bonds, which increases demand for them and this, in its turn, raises their prices. As a result, some equilibrium price settles down.

CASE ONE: U.S. GOVERNMENT DEBT

U.S. Federal Government debt amounts to approximately 18 trillion dollars. Practically all this debt is placed in the form of securities (roughly speaking, the same bonds). On the one hand, it means that citizens, companies, financial organizations and even foreign states have savings in the amount of 18 trillion US dollars.

Remember the worker from our example, who instead of spending money deposits it in a long term account in a bank and in doing so generates the GDP? Exactly like him, these US debt holders (more precisely, the first buyers of these debt obligations) participated in generating the US GDP in the amount of 18 trillion US dollars, but at the same time they agreed not to spend the money they had earned and to set it by in the form of savings.

Probably, Egor Gaidar (and Vladimir Nazarov) would have been dismayed, having realized what a gigantic «money overhang» this was. As the annual GDP of the USA (approximately 17.7 trln.

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[6] For example, almost always a high degree of reliability is typical of the government obligations denominated in local currency (though there happen such asininities as the 1998 crisis in Russia, when the debt denominated in Rubles was defaulted).

[7] Only as a result of discount, without counting possible interest revenue.

USdollars in 2014) is less than the amount of this debt. While money supply M2 in the USA, being «only» approximately 12 trln. USdollars, is also significantly less than the Federal government debt. But the surprising thing is that nothing terrible is happening in the USA. Nobody perceives the enormous government debt to be «money overhang». There is no threat of spiraling inflation, falling dollar (at least, on the part of the government debt) in the USA. The thing is that everything is working in accordance with the system which is depicted in diagram 2. And this system is almost impossible to destroy, even if you are anxiously keen to do that. Moreover, in the case of instability, this ***system automatically works for the strengthening of the dollar***, which underlies it.

Let us now consider a hypothetical situation where all the foreign holders of the US government debt (cumulatively they own the bonds worth approximately 6 trln. US dollars, which makes up approximately one third of the total debt) decided, out of spite, to sell off all the bonds that they have in order to undo or subvert the financial system in the USA.

- Sale of a large volume of bonds means decline in their prices. The «saboteurs» would sell the assets ending up with losses.
- Sale of a large volume of dollar denominated assets means growth of demand for dollars. That means the dollar exchange rate will rise. And instead of inflation and collapse of the dollar, «the saboteurs» would end up with stronger dollar and lack of inflation in the USA.
- Falling bond prices would mean that they become a more attractive investment (see above the example about the 100-Ruble bond for 90 or for 80 Rubles). This would attract other investors both inside the country and from all over the world. Bonds will start selling and the prices will quickly begin to return to their initial level. If necessary, the buyer's role can be played by the US Federal Reserve Service with an «unlimited» resource of dollars in the form of their «printing press».
- Finally, the United States Department of the Treasury in charge of repayment of the debt can take advantage of the situation for their own benefit. As by buying out the devalued bonds, it can settle its debts and save on this.

In certain sense, it is impossible to subvert this system from outside. It is only the USA herself that can break down this trouble-free operating machine. For example, by refusing to pay the debts denominated in their own currency.

Though there is one more method of subverting this system, i.e. the Gaidar way. More on this, see below.

CASE TWO: SOVIET SAVINGS AND GAIDAR'S MISTAKE

On the one hand, «history brooks no subjunctive mood». And talking about «what would have happened, if …» is often a thankless task, often unverifiable in practice. And again, it is easy to be smart «by hindsight», i.e. after something happened already.

On the other hand, «you learn by making mistakes». And if you cannot draw lessons from somebody else's mistakes, it would be nice to analyze your own, at least. This is exactly why it is very important to understand what could have been (if at all) done in order to retain the savings of the Soviet times. While a solution had been there. And its understanding could help steer a proper economic course in Russia today.

What exactly happened in early 1992? Everything looked very much like a vicious circle. The main thing that did away with citizens' savings (and not only those of the citizens, but of organizations, too) was inflation. And the main reason of inflation were … citizens' savings (and enterprises' savings), which inundated the consumer market. Everything was exactly the way it is illustrated in diagram 1.

During the Soviet times, citizens' savings did not inundate the consumer market due to physical restrictions on the market (notorious shortages, intimately connected with administratively regulated prices). Everything exactly the same way as in the example quoted above describing the USA during the years of the Second World War. During 1991, restrictions were also imposed («a freeze») on some of the deposits which was instituted for the purpose of compensating for price increases in April 1991.

Precisely the same way, cashless funds held by the enterprises were precluded from finding their way into the consumer market. Generally that was absolutely special money whose transformation into payroll or cash during the Soviet times was very strictly regimented[8]. In other words, in the USSR there were not such barriers as are shown in diagram 2, between the citizens' savings (those of enterprises) and the money in the consumer market. But the borderline between savings (and cashless money of the enterprises) was not proforma one at all, as in diagram 1. There existed barriers of a different nature.

In January 1992, these barriers were removed and the consumer market was flooded immediately with citizens' savings and enterprises' funds easily cashable under new conditions.

Metaphor: *Not far from a dam down the river, there was a small city. The water from the water reservoir helped irrigate the fields during the drought. The water falling down from the dam would move the mill.*

[8] Though with the advent of the first cooperatives «technologies of cashing cashless reserves» began to boom.

A new Ruler came, and blew up the dam. The city was swept off by the water flooding it. Many people were injured and killed. The mill stopped operating. During the time of the drought which set in soon, there was nothing to irrigate the fields with. Some of the dwellers left these parts for ever in search of a better life.

In reply to all reproofs, the Ruler said: «This "water overhang" always hung over you. Only thanks to me after the blowing up of the dam were you able to understand that it was dangerous. Though instead of that, this reservoir is no longer there and you can enjoy all the beauties of quiet life without "water overhang"».

The cause of the hideous inflation in 1992 was not the money overhang in the form of citizens' savings (and the enterprises' cashless funds), it was the fact that all the barriers between money in the consumer market and these savings were destroyed. It is amazing that Gaidar's supporter, Vladimir Nazarov, even credits Gaidar with destruction of these «dams».

In April 1991, in the course of the so called «Pavlov's reforms» the prices were significantly jacked up. In order to prevent citizens' deposits from devaluating, it was decided to compensate for that devaluation. However, one was not supposed to take advantage of this compensation – they were credited to special compensation accounts, from which you were allowed to take money only 3 years later (i.e. in 1994).

But «thanks to» Gaidar, all and various «dams» were done away with, preventing the flow of money from flooding the goods market and letting inflation spiral out of control. This one was also destroyed, about which Nazarov and Rodionov (2012) write, as an outstanding achievement under Gaidar's belt. «E.T. Gaidar and B.N. Yeltsin did not give up on compensations, on the contrary, they opened access for citizens to compensation accounts, which were denied to people by the Soviet leadership, for a period of 3 years». The same book quotes the words said by Gaidar himself: «… I did not freeze the people's savings, I unfroze people's savings. If there was someone who froze the people's savings, it was Valentin Sergeevich Pavlov, the last Prime Minister of the Soviet Union. He indeed froze the people's savings when he raised prices in the spring of 1991. I unfroze them»

Everything is understood by comparison. We have already said above that the system of savings in the USA is very stable and it can «be blown up» only from inside, for example, by refusing to repay debts. But there is one more way: «the Gaidar way». Let us now imagine how it could have transpired.

Oil painting:

- The US economy develops problems (something like the 2008 crisis would quite suit to serve as an example)
- All the reins of economic power in the USA are obtained by someone like Gaidar

- It is announced that US large government debt is the main problem
    - «Our government debt in the amount of 18 trillion USdollars exceeds our annual GDP!»
    - «Such a debt has piled up as a result of previous administrations' populism!»
- Existence of barriers between savings and the money supply (see diagram 2) is declared to be a «freeze» of savings, which (unfairly) was conceived of by previous authorities.
- It is announced that all the savings «are to be unfrozen». For this purpose, all the bonds in no time are converted to dollars in cash
    - «Market will show what really these savings are worth»

What happens next?

- As we have already mentioned, the money supply in the USA now amounts to approximately 12 trln. dollars. The 18 trln. USdollars suddenly added to them accelerate inflation to unheard-of levels.
- The fire of inflation does not «burn up» the savings only, it also «burns up» money supply. As it is nominally expanding, in terms of its real purchasing power it drastically «contracts».
- The economy keeps on sinking deeper and deeper into the depths of the crisis.

«The market itself has shown what ~~Soviet~~ American citizens' savings are worth: they were worth exactly as much as one could purchase for ~~socialist~~ illusions» (this is a slightly modified quotation from Nazarov which was cited above).

The reader can come up with the title for the painting himself.

CASE TWO, CONTINUATION: SOVIET SAVINGS – THE RIGHT SOLUTION

Did there exist the right solution in Russia for the problem of the citizens' «Soviet» savings? Yes, there did. The right solution would have been the decisive transition to the configuration which is depicted in diagram 2. To do this, only two steps would have had to be made:

- **Step One.** Convert all the citizens' savings and the companies' cashless funds to long term bonds of the Bank of Russia (for example, 5, 10, 15, 30 years), to be indexed every year (or more often) by the level of consumer inflation.
- **Step Two.** Set up trading infrastructure to trade in these bonds.

Please note that Step One without Step Two only means «freezing» of deposits (for the same periods as above: 5, 10, 15, 30 years) without option to use them. This, of course, cannot be recognized to be fair (though even such a scenario is better that what actually transpired).

If it is allowed to trade in such bonds and the relevant infrastructure has been put in place, then the people who are desperate for money can sell their bonds. Besides, as illustrated in diagram 2 and in the case about the US government's debt, this does not bring about inflation, and, on the contrary, generates demand for (cash) money, which only strengthens the local currency and the monetary system.

These two steps would allow multiple problems to be solved right away:

1. There would be no inflation, caused by liquidation of savings and the cashing of the enterprises' funds.
2. The citizens who need money badly would be in a position to obtain cash by selling off their savings in the form of bonds.
3. Other citizens, who hold surplus cash, instead of brining «pressure» to bear on the consumer or foreign exchange market, would be able to purchase these bonds relying on interest revenue and establishing long term savings.
4. The enterprises would also be in a position to sell their bonds or to obtain, by pledging these bonds, credit facilities of the Central Bank or granted by commercial banks.
5. The stock market of Russia would be given a powerful impetus (in reality it got the first noticeable impetus much later, only with the beginning of the so called «Pyramid of State Treasury Bonds»)
6. Provision could have been made for a possibility of using savings as bonds in the process of privatization.
7. The Bank of Russia would have had an opportunity of regulating the money supply in the country (by buying or selling bonds) and would have had a market index of money supply sufficiency (high yield in the bonds market is a sign of money shortage).

To be quite fair, it must be stressed that transition to market was necessary. It was exactly the lack of market relations in the USSR that resulted in a situation where citizens' huge savings were not perceived by anyone to be potential demand. We have mentioned above that many solvent buyers are «paradise» for the entrepreneur. It is just that in the USSR, alas, there were not enough entrepreneurs.

An idiosyncratic collision developed: the transition to market relations opened up opportunities for entrepreneurs, but the principal opportunity (in the form of customers' demand) was reduced by orders of magnitude for many long years.

There is once more nuance which is worth paying consideration to. It is proposed that the bonds be issued by the Bank of Russia rather than by the government (Finance Ministry). The difference consists in the fact that the Finance Ministry is constrained in its actions by the framework of the budget. But there is no need at all to spend budgetary money on this. In the rendering of the Central Bank, the operation becomes similar to the process of exchanging money during denomination. In January 1998, in exchange for old banknotes people were issued the banknotes which were equivalent in terms of purchasing power but with lesser number of zeroes. Same goes for the proposed scheme: people, instead of their deposits, would have been offered (instead of banknotes) bonds equivalent in value like banknotes with increasing (in line with inflation) number of zeroes.

When this article was being prepared for printing, interesting news arrived. President of Kazakhstan **Nursultan Nazarbaev** tasked the National Bank of Kazakhstan (note, not the Government!) with making compensation, similar to the one described by us: «I hereby task the National Bank with implementing the mechanism of compensation for term deposits of the physical persons which have been opened in the tenge as at August 18-th 2015»

CONCLUSIONS FOR PRESENT DAY RUSSIA

Let us try to frame two practical pieces of advice for Russia's leadership.

FOR SAVINGS TO GROW IN RUSSIA, IT IS REQUIRED THAT INSTRUMENTS BE CREATED

Growth of the population's savings (and not only that of the population) in Russia is not only needed for economic growth but it is quite possible. For that, it would be only necessary to create relevant instruments and to sell them. By the instruments, securities are understood which should be reliable and should not cause doubts in investors' minds.

Such securities could be well issued by the Central Bank (as it is not constrained by budgetary limitations) and this fits quite snugly into the Bank's obligation to maintain prices stability and regulate the quantity of money in the economy (including liquidity of the banking system).

The key requirements applying to these securities are just the following three: they must be nominated in Rubles; they must be «long»[9]; they must protect investors from key risks, inherent in Ruble denominated investments. Specific types of such securities may be determined in the course of consultations with market players, i.e. as a result of, as it were, marketing studies. But «on top of one's mind» there are ideas of such securities as the following ones, for example:

1. **«Inflation Protection»** - Bonds of the Bank of Russia whose nominal value is regularly indexed in accordance with the data on consumer inflation.
2. **«Ruble equivalent of the dollar»** [10]. – Bonds of the Bank of Russia whose nominal value changes with the change in the USdollar's exchange rate.

[9] Now the Central Bank is in a position to issue the Bonds of the Bank of Russia for a period of up to 5 years.
[10] In essence, by the sales price of «foreign exchange» Bonds of the Bank of Russia, the Central Bank would be setting a benchmark for the foreign exchange rate using Ruble resources only. For example, if the Bonds of the Bank of Russia «Ruble equivalent of the dollar» are to be sold by the Central bank at a price of, say, 50 Rubles or at any other price below the current exchange rate of the dollar at 69 Rubles (as at August 23-rd 2015), the

3. **«Ruble equivalent of the euro»** - Bonds of the Bank of Russia whose nominal value changes with the change in the Euro's exchange rate.
4. **«Ruble Basket of Currencies»** - Bonds of the Bank of Russia whose nominal value changes with the change in the basket of currencies calculated in a definite manner

Let us consider a numerical example. Let us assume that the Central Bank is to sell 7 trln Rubles' worth of such instruments. (Right away the question comes up – and for what money will they be bought? Answer: the same money for which foreign exchange is bought, for example. At the end of the day, this is only a matter of the price, i.e. discount, with which the securities will be offered for sale). And then the following benefits will be achieved:

- Pressure on the foreign exchange market will ease up (the situation may even «turn around» - an inflow of foreign exchange will set in).
- The volume of «long» money in the economy will go up by 7 trln. Rubles
- The so called «pledge base» would grow by 7 trln. Rubles, which, firstly, would allow the banks, virtually without risk, to provide credit facility to holders of the Bonds of the Bank of Russia for a long period of time, and, secondly, allow the banks themselves to obtain credit facilities from the Central Bank against the pledge of the Bonds of the Bank of Russia.
- The Central Bank would be provided with the opportunity of carrying out an additional issue of 7 trln. Rubles without any threat to cause inflation
- The GDP would grow (only thanks to this operation) by 7 trln. Rubles (and this would be about 10% of the GDP)

When, during a definite period of time, the volume of the Bonds of the Bank of Russia in the market reaches and exceeds the money supply volume M2, Russia's financial system will acquire previously unheard-of stability (see above the case about the US government debt).

«REVIVAL» OF SOVIET SAVINGS IS DOABLE AND THIS IS GOOD FOR RUSSIA

It is often that the past mistakes cannot be rectified. Fortunately, Gaidar's mistake, which culminated in annihilation of savings, is corrigible (unlike the warped fates of people in the 1990-s in Russia).

However weird it may seem, but Russia's recognition of the debt to the citizens who had savings during the times of the USSR, is good for Russia herself. Such a step, in case it is

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arbitration operations of the market players will result in the exchange rate close to the level of 50 Rubles per dollar beginning to establish itself also in (spot) foreign exchange market. Apart from that, for this equivalent of «currency intervention» the Central Bank will be using the infinite resource of Rubles in the form of hypothetical «printing press» rather than the foreign exchange resource (which is constrained by foreign exchange reserves)(also see Blinov, 2015c) properly implemented, would give Russia tremendous advantages compared to the current situation:

- Firstly, this way, the «longest» money would be created very quickly the President has been speaking about and which the Russian economy is so badly short of.
- Secondly, virtually the same robust and invulnerable to external impacts system as was described above in the case about the US government debt would be put in place
- And last but not least – historic justice would thus be done to those who lost their savings (justice to their heirs).

What amount are we talking about? Unfortunately, the amount of the savings accumulated as of the time that the USSR collapsed, is unknown to me. Let us try to use as reference the data quoted by Illarionov and Nazarov which were given above. According to the data given by Nazarov the «money overhang» (surplus quantity of money over and above the stock of goods) as at the end of 1990 constituted 490 bn. Rubles. According to Illarionov (see table 2), the similar indicator made up 259 bn. Rubles. Let us assume for our calculations the amount of savings at the end of 1990 to be equal to the sum of **260-490 bn.** Rubles.

If one Ruble as at the end of 1990 is to be indexed in line with the index of consumer prices and include denomination of 1998 («deletion» of three zeroes), that Ruble will then convert to 86 Rubles of July 2015[11]. For example, if as at the end of 1990, a Soviet Savings Bank deposit was 1 thousand Rubles, then (if this deposit is indexed) as at July 1-st 2015, it would equal 86 thousand Rubles.

Basic calculation (multiplying by 86) shows that 260-490 bn. Rubles of the end of 1990 equal (in the case of their indexation) the amount of **22 – 42 trln. Rubles (**present day Rubles) (July 2015). For comparison: GDP of Russia in 2014 amounted to 72 trln. Rubles, money supply M2 in Russia (as at July 1-st 2015) made up 32.5 trln. Rubles. That is, the amount of savings can be comparable to the money supply and the volume of the GDP.

The exact number is unimportant to us. In any case, the technology of calculation is understandable – determining the amount as of a specific date in the past, and then indexing it. For the sake of clarity of the example, let us opt for the amount of **42 trln. Rubles**.

If the Bonds of the Bank of Russia in the above mentioned amount are issued (to be indexed and long term) and transferred into ownership by the people who lost their savings as a result

[11] Formally the process of deposit compensation is now in progress. But it is limited by the age of the depositors and compensates for a paltry fraction of the losses. Thus by 2015 compensations will have been paid to the citizens born in 1945 (70 years of age) and older. Per 1 Ruble deposited as at June 1991, 3 present day Rubles will be paid (when indexed in line with the consumer price index, it would have required 43 Rubles).

of the Gaidar reforms and if free circulation of these bonds in the exchange is organized, this will then be a solution of the issue.

It would require time for such technicalities as issue of deposits and, for example, searching for heirs. But for these savings to work, they (until complete settlement of debts) can be managed by an ad hoc foundation or one of the existing institutions (for example, VEB, Russian State Bank for Development).

And thus justice will be done; the Russian stock market will then become more conspicuous in size; the volume of «long» money in the economy will grow by 42 trln. Rubles; there will arise an additional demand for Rubles (which will be a factor instrumental in making the Ruble stronger).

It should be specially mentioned that the redemption period for the bonds must not be focused on one «point». The bonds have to be different: five- , ten- , fifteen- , thirty year bonds. Secondly, work aimed at managing savings in the form of such bonds must be done on an ongoing basis. The task of the regulator is to «spread» the obligations time-wise, for bond payments to be effected at as uniform a frequency as possible.

CONCLUSION

We have seen that savings play an enormous positive role in the development of the economy. And accumulation of savings as well as their subsequent expenditure contribute to the GDP growth. Besides, savings help get rid of inflation. They also facilitate investments thanks to appearance of «long» money in the financial system.

However, improper management of savings on the part of the economic authorities may not only cause citizens and organizations to lose their savings but also lead to acceleration of inflation, reduction in purchasing power of all the money in the financial system and to very serious problems in the economy.

It was precisely the mistakes in the management of citizens’ and enterprises’ savings when reforms were carried through by Egor Gaidar and his like-thinkers that resulted almost in full loss of citizens’ savings. As a result of these mistakes, the Russian economy suffered disastrously. As a consequence, people also suffered, their living standards lowered, birth rate declined. All this could not but tell on the internal political stability of the country, on Russia’s prestige on the international scene in the 1990-s.

Since then more than 20 years have passed by. Many things cannot be reinstated but there is a way of restoring savings to the public. And this can be done with a benefit for the Russian economy.

Regardless of the desire to restore the Soviet savings, the economic authorities can make several simple steps, which would enhance reliability of citizens' and enterprises' savings. In this case, the Russian financial system would become much more stable.

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