

Price regulation: An adequate instrument to fight inflation?

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Executive summary

Like in most of the countries around the globe, the COVID-19 pandemic had several negative economic implications on Belarus. One obvious impact was rapidly rising inflation, which stands currently (June 2021) at 9.9% yoy. This level is far beyond the target rate of 5% of the National Bank of Belarus.

The authorities reacted rather quickly to appearing inflationary pressures by adopting Resolution No. 184 of the Council of Ministers as of 30 March 2020 to temporarily limit price growth from an administrative point of view. This initial move, which has been further developed over time, came against a pre-existing system of administrative price controls for certain, socially important goods. From an economic point of view, the key question is if this is the right instrument to fight inflation and protect consumers, even in the current situation of crisis, or if other instruments should be preferred.

This paper provides a thorough overview of the existing regime of administrative price controls, which was to a major part already in place before the recent COVID-19 crisis. Based on standard microeconomic arguments, we argue that such controls lead to economic welfare losses, and likely create shortages for the goods concerned. A better way to handle the inflationary pressures would be to follow tight macroeconomic policies, ideally combined with targeted social assistance for low-income households, as well as an effective system of competition that keeps market power in check.

1 Introduction

The recent COVID-19 pandemic had several negative economic implications for Belarus. One of them was the associated depreciation of the Belarusian Ruble, which – not surprisingly – was accompanied by growing domestic prices (“pass through”).

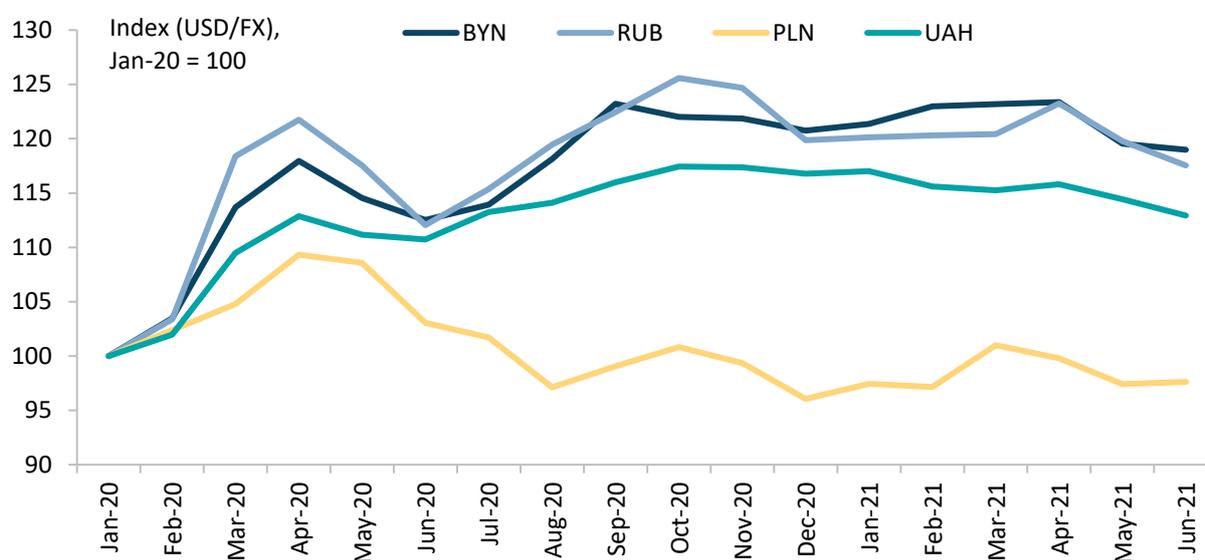
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The paper is structured as follows. Chapter 2 will provide a background on recent FX and inflation developments. Chapter 3 gives a detailed overview of recent tightening of administrative price regulation in Belarus. The following section 4 will analyse the economic implications of these regulations. In chapter 5 we conclude.

2 Background: Recent inflation developments

As can be seen from Figure 1, the COVID-19 global crisis led to FX depreciation pressures on a broad front, not just in Belarus. Weaker exchange rates in emerging markets were rather an international phenomenon, and part of the policy response.

Figure 1. Recent exchange rate dynamics in Belarus and neighbouring countries

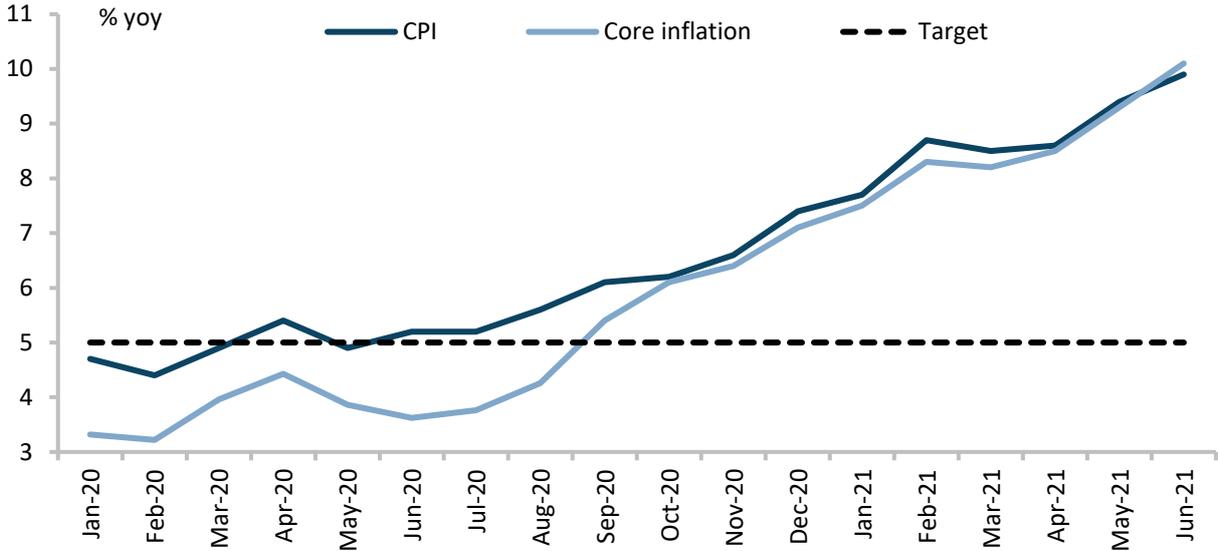


Source: National Banks, GET calculations

Obviously, adverse FX dynamics can put pressure on consumer prices (“pass through”). While empirical estimates of CPI pass-through vary¹, the evidence suggests that pass-through appears to increase during times of sharp exchange rate adjustments as observed in 2020.

¹ See IMF Country Report 15/137 (2015) for various estimates of pass-through in Belarus.

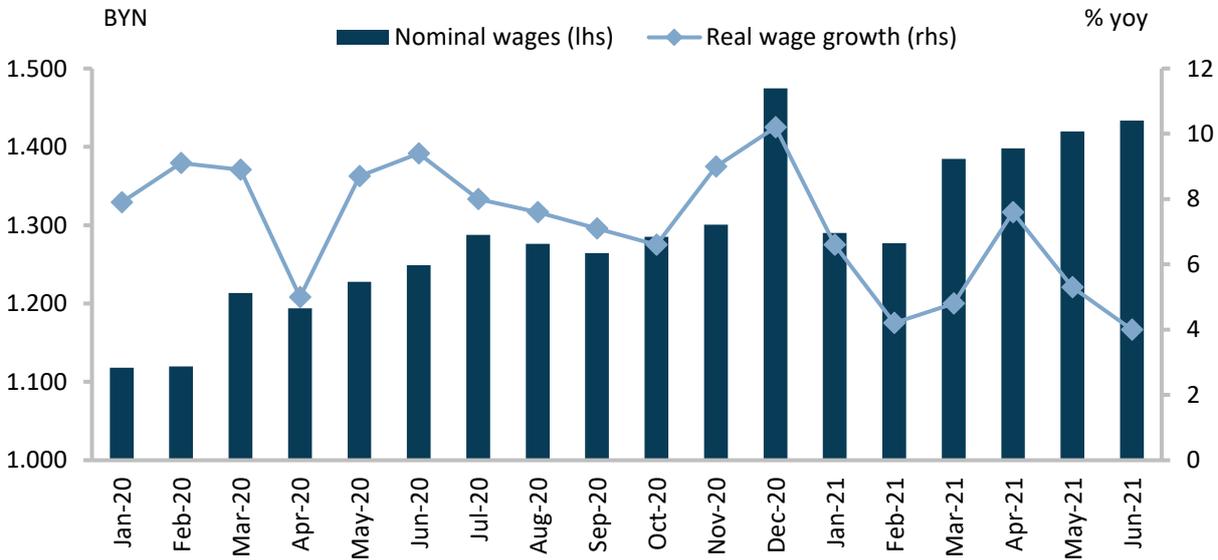
Figure 2. Consumer price inflation in Belarus



Source: National Bank of Belarus

While recent FX and inflation developments (with CPI inflation moving quickly away from the target) suggest a close causal relation, FX dynamics are most likely only one factor among others. Wage dynamics were also quite strong recently, despite the crisis, likely pushing inflation up from both sides (demand and supply).

Figure 3. Monthly wage growth in Belarus



Source: Belstat

Conclusion 1: Belarus is currently facing growing inflation pressures, with CPI inflation moving away from its target. Underlying reasons for that appear to be adverse FX dynamics and associated pass-through, as well as strong wage dynamics during the crisis.

3 Administrative price regulation in Belarus

3.1 General overview

In recent months, against the background of increasing inflation and depreciation expectations in Belarus, the regulation of prices has again been the subject of frequent public debate. In addition to the laws in force already containing several provisions for influencing prices (see below), on 24 February 2021 another regulation came into force (see 3.2.2b).

The most important legal basis is the Presidential Decree No.72 as of 25 February 2011 "On Various Issues of Price Regulation in the Republic of Belarus".² The Decree grants corresponding authorisation on which further differentiation is then made in subsequent legal provisions.

In principle, price regulation is possible in the case of natural monopolies, dominant market positions, medical products (with differentiation between domestic and foreign/imported goods) and in other cases provided for by law. The following table of the competent bodies and their respective areas of regulation illustrates the scope of the applicable authorisation principles, which have been designed to partly overlap and/ or complement each other.

Table 1. Competent bodies and their respective areas of regulation

Competent body	Area of regulation
1. Council of Ministers	<ul style="list-style-type: none">• Municipal services• Customs tariffs, transport tariffs• Defense Technology• Broker's fee• Notary fees
2. Ministry of Antitrust Regulation and Trade	<ul style="list-style-type: none">• So-called "socially significant goods"• Alcohol• Goods/services from legal entities with dominant position• Transit charges for oil+gas• Airport taxes and air traffic control• Guard services by the MWD• Transport of goods within the country• Train tickets for natural persons• General railway services• Electricity and postal networks
3. Ministry of Architecture	<ul style="list-style-type: none">• Price regulations for all buildings financed or supported by the state and for residential buildings
4. Ministry of Health	<ul style="list-style-type: none">• Medicines, medical devices• Medical services ("paid" or private)• Price control for domestic medicines
5. Ministry of Education	<ul style="list-style-type: none">• Remuneration for studies, training
6. Ministry of Industry	<ul style="list-style-type: none">• Scrap and non-ferrous/black metals
7. Ministry of Agriculture	<ul style="list-style-type: none">• For agricultural products purchased for government purposes

² Presidential Decree No. 72 of 25 February 2011 „On Certain Issues of Price Regulation in the Republic of Belarus“.

8. Ministry of Transport and Communication	<ul style="list-style-type: none"> For building materials, products, constructions, works, works and services, in the construction and maintenance of roads, bridges and tunnels where there is (partial) public financing or support
9. Ministry of Finance	<ul style="list-style-type: none"> Precious metals and precious stones (purchase and sale) In particular, purchase of scrap metal, purchase of banks
10. Belneftechim	<ul style="list-style-type: none"> Petroleum Products
11. National Bank	<ul style="list-style-type: none"> Precious metals and precious stones in banking operations
12. Presidential Operational-analytical Centre	<ul style="list-style-type: none"> Telecommunication services for the connection of data-networks (inclusion, access, infrastructure use)
13. Regional and Minsk City Executive Committee	<ul style="list-style-type: none"> Socially important goods (unless regulated by MART) Municipal charges (water, heat, waste for private and commercial use) Transport tariffs public transport, city

Source: Presidential decree No. 72 as of 25 February 2011 "About several price regulation issues in the Republic of Belarus" as amended from time to time.

Current Belarusian law systematically provides a number of mechanisms for the bodies authorised to do so to influence prices. For example, fixed prices, marginal prices, marginal surcharges, target prices or marginal profitability can be set. It is also possible, however, to index prices or to prescribe certain pricing methods.

Due to the variety of product groups and powers, it is not possible to deal with each individual case in the context of the present investigation. Therefore, in the following the "socially significant goods" will be examined in more detail.

3.2 Socially important goods

The regulations on socially important goods are among the price regulations which enjoy the highest public attention, as changes in these areas are directly perceived by the public. The regulation here is based on the above-mentioned Presidential Decree No. 72 of 25 February 2011, which is further specified in the Resolution No. 35 of the Council of Ministers of the Republic of Belarus of 17 January 2014 and then implemented in concrete terms by the Ministry of Antitrust Regulation and Trade (MART).

3.2.1 Scope of application

The "socially important goods" are those which are of such importance to the life of the average citizen that the authorities of the Republic of Belarus consider that the prices of these goods should be regulated by the state. According to the corresponding MART regulation ("On Regulation of Prices for Socially Important Goods", permanently updated and amended by Regulation No. 83 of 28.12.2020, amended by Regulation No. 9 as of 10.02.2021 and again amended by the Regulations No. 19 as of 26.03.2021 and most recently by No. 40 as of 01.06.2021 and No. 48 as of 29.06.2021) until 23.09.2021 17 goods or groups of goods respectively (see Table A1 in the Annex) are classified as socially significant by MART.

Whereas in the past price controls were carried out on a very small scale and included detailed specifications for package sizes (for example, the price of fresh milk was regulated in 1-litre tubular bags, but not milk in PE bottles or other package sizes), the legal possibilities for circumvention are now more limited due to the changeover to product groups. However, it is still possible to add or amend ingredients or add additives to goods that are actually socially important, which then again allows unregulated price formation. As an example: curd cheese (“Tworog”) is regulated, whereas curd paste/food (“Tworozhnaya pasta”) produced by adding sugar and other raw materials is not.

3.2.2 Price regulation technique

The regulation of prices for social important goods is done in Belarus mainly through two institutional bodies / regulations. A compact overview is presented in Table 2. In the following, each of the regulations will be discussed in more detailed.

Table 2. Price regulation of socially important goods



Source: Own display

a) *MART-regulation*

The price regulation for the socially important goods depends on whether the limitation of profits (and thus the prices of the goods) is regulated for producers, importers or for the entire supply chain.

For **producers**, the maximum marginal rate of return is used to determine the amount of profit to be included in producers' selling prices for socially significant goods sold on the territory of the Republic of Belarus. It is determined at the actual level of profitability of the products if the profitability was higher than 10 percent and at 10 percent if the actual level of profitability was below 10 percent in a defined period.

For **importers**, the maximum marginal rate of return used to determine the amount of profit to be included in the selling prices of socially significant goods amounts to 10 percent. The selling price of socially important goods (without the premium) shall be established by the importer on the basis of contract prices, import costs (customs payments, cargo insurance, interest on loans, transportation costs and other costs in accordance with legislation) and sales costs.

Wholesale profit margins to the selling prices of producers (importers), prices set by legal entities and individual entrepreneurs engaged in storage and sale of stabilization funds (reserves) of food products and (or) procurement from agricultural producers and the population for socially important goods may not exceed the amounts foreseen in the regulation, regardless of the number of legal entities and individual entrepreneurs involved in the sale of these goods. The total cap ranges from 15 percent

(dairy products and sugar) to 30 percent (e.g. as in the case of canned fish and cheese) depending on the product group.³

The respective resolution's period of validity is limited to 90 days after its official publication which is in line with the rules of the Eurasian Economic Union (EAEU). However, in practice it is to consider that the price regulations imposed by MART are de facto permanently in force by altering, modifying and re-adopting the relevant decisions and/or the list of regulated goods⁴.

b) Resolution No. 100 of the Council of Ministers as of 25. February 2021

The Council of Ministers adopted already in Spring 2020 a decision⁵ in order to limit the growth of prices. In particular, it stated that legal entities of all forms of ownership and individual entrepreneurs who produce (import) and (or) sell goods on the domestic market or provide services were obliged not to increase prices above 0.5% per month. Price increases above this limit were allowed only in agreement with the Commission on State Price Regulation under the Council of Ministers. Said resolution No. 184 was in force until 18.04.2020.⁶

Almost a year later, a new resolution No. 100 of the Council of Ministers came into force on 25.02.2021 and introduced measures to stabilise prices for socially important essential goods. The authority to issue resolution No. 100 was given by presidential decree No. 143 "On economic support" allegedly aiming for a minimization of the impact of the global epidemiological situation on the Belarusian economy.⁷ The expiry date of the measures enshrined in Resolution No 100 has not been set at the moment.

Thus, according to the government's decision, legal entities of all forms of ownership and individual entrepreneurs engaged in production (import) and/or sale on the domestic market of socially important goods shall not raise prices for such goods for a transition period at the end of February 2021 at all, and from 1 March 2021 onwards the monthly change of prices for socially important goods shall not exceed 0.2% of the price for such goods, established on the last day of the previous month.

Price increases exceeding this threshold are subject to a decision of the Commission for State Regulation of Pricing under the Council of Ministers of the Republic of Belarus.

The list of socially important goods of prime necessity includes 62 items such as rice, buckwheat, semolina, barley, millet, chicken, milk, kefir, sour cream, cottage cheese, eggs, matches, etc.

The list of medicines includes 50 items. According to MART the list includes domestically produced medicines, while food products are mainly produced in the Republic of Belarus⁸.

³ One should pay attention to the fact, that the list defining the "socially important goods" (see Annex 1 to the Resolution No. 48 as of 29.06.2021) is containing less items than the list establishing the maximum allowed profit margins (see Annex 2 to the same Resolution). According to Annex 2 the profit margins for buckwheat and sugar are capped even if they are not defined as "socially important" anymore.

⁴ By using this approach, price regulations for an almost identical product basket are permanently in force since more than 10 years.

⁵ Resolution No. 184 of the Council of Ministers of the Republic of Belarus of 30 March 2020.

⁶ Originally, the resolution No. 184 entered into force on 1 April and should have been temporary in force until 30.06.2020.

⁷ Resolution No. 100 of the Council of Ministers of the Republic of Belarus "For the temporary stabilisation of prices for socially significant goods of basic needs" based on the Presidential decree No. 143 "For the support of the economy" as of 24. April 2020.

⁸ It is interesting that the state chose this way for influencing prices for medicines – since the state is the owner of most of the companies producing medicines on the list a shareholder's order could have had the same effect.

c) Similarities and differences

Part of the list of goods included into Resolution No. 100 is the same as the list of socially important goods for which the MART can impose restrictions for not more than 90 days within one year (see above). For such goods, business entities should consider both the resolution introduced by the MART (during the period of its validity) and the norms of resolution No. 100. Both resolutions are meant to damp price increases for particular goods. However, the approaches are different: Whereas the MART regulation restricts the profit margin for participants in the sales chain (importers, wholesale, sale) – allowing them to increase prices in case of raises in the initial cost price provided that they remain within the established margins – the new regulation restricts price increases exceeding a certain rate compared to the previous month. So even if purchase prices increased by more than 0.2%, – e.g. because of changes in the exchange rate or general purchase price increases in the market – the sales price can't be increased without obtaining a separate decision⁹ on that affecting the margins of the participants in the sales chain that is why the new regulation must be considered as a more intense intervention.

Conclusion 2: Price control has a long tradition in Belarus and is executed frequently by various administrative bodies with parallel and sometimes overlapping competencies as it is the case with the awareness sensitive “socially important goods”. However, the various existing mechanisms were not considered sufficiently to fight price increases, so that Resolution No. 100 was adopted for parallel application alongside the existing regulations tightens price control for the group of goods covered, as increases in purchase prices cannot be passed on by default. As the experience of the last few years shows, this is particularly often the case with imported goods (paid for in foreign currency), thus shifting the risk of devaluations of the Belarusian Ruble or general increasing purchase prices for the goods concerned to the economic entities. For them it is merely unpredictable if and when they receive a decision allowing them to pass their higher costs.

4 Economic implications of price regulations

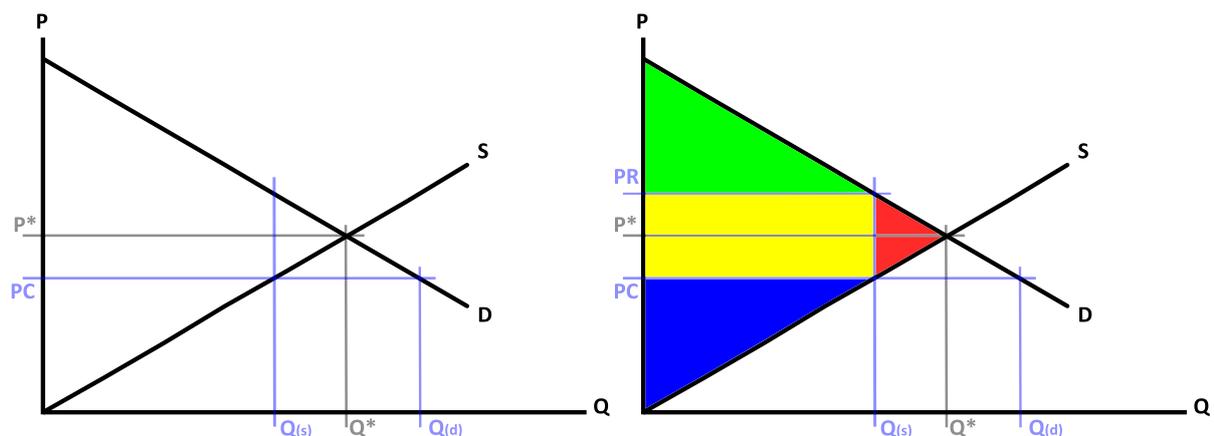
Price regulations and their economic implications is a topic which is widely discussed in every textbook on the principles of microeconomics. In a well-functioning market economy with flexible prices and perfect competition, supply and demand are expected to meet in an equilibrium and thus ensure the optimal allocation of resources and maximize the welfare surplus of all market participants. Flexible prices are an important signal for market participants and ensure an optimal allocative efficiency. Sometimes, governments may find it wise to intervene in the market and set a price ceiling (maximal price) or price floor (minimal price). This often stems from the impression, that a given price is “not fair”. While the perception about the level of a “fair price” is very subjective and varies across market participants, there are cases where regulations rightfully address market failures such as surplus production by large market participants that aim to drive the smaller competitors out of the market by

⁹ Such decision allowing to increase prices over the thresholds indicated in regulation No. 100 was recently taken by MART in favor of the sellers of bread, bakery goods or children's food, see <https://www.belnovosti.by/ekonomika/mart-anonsiroval-povyshenie-cen-na-hleb-i-detskoe-pitanie> and it is to be expected, that MART will continue its “manual steering” approach for other products, e.g. rice.

(temporarily) lowering the price. In most cases, however, price interventions are likely to distort the efficient allocation of resources in the market or even create shortages.

Many countries in Central and Eastern Europe make use of price regulation and especially price ceilings as an instrument to regulate certain goods and services. Often, the main objective of such regulations is to keep inflation at bay rather than eliminate market failures. Some typical examples would be regulated tariffs for housing utilities and prices for agricultural products or, more recently in the wake of the COVID-19 pandemic, medical goods. An example how price regulations may affect the efficient allocation of resources can be discussed with the help of a simple supply and demand diagram depicted in Figure 5 below.

Figure 4. Implications of a price ceiling (“maximum price”)



Source: own display

Another related question is how a price ceiling affects the overall surplus of the market participants. This is depicted in the right diagram of Figure 4. The surplus of the supplier is the blue area between PC and the supply curve. As PC and $Q(s)$ are both lower than the price and quantity that would have prevailed in the unregulated market (P^* and Q^*), the supplier surplus also logically becomes smaller. The consumer surplus, on the other hand, are the green and yellow areas between PC and the demand curve. In our example, the consumer surplus in the regulated market is larger than in the free market. Overall, a wealth transfer from the producer to the consumer took place. What is left over is the red area, which is neither claimed by the supplier nor the consumer. In the free market, there would have been market participants who would still have liked to buy/sell the good or service but cannot do so anymore with the imposed price regulation. Thus, the total surplus in the regulated market has become lower. This red area is also called the “deadweight loss”.

However, the theoretical implications behind a price ceiling do not end here. As previously mentioned, demand exceeds supply, leading to a shortage of goods. In other words, the consumers now have to compete between each other in order to get the good. This can take many forms and will cost the consumer additional resources such as time, energy, or even money. If one assumes, that the goods will be sold under the “first-come, first-served” principle, it is likely that large queues will form in front of shops and people will have to waste their time (e.g. waking up earlier, standing in the line, etc.). This will raise the “real price” of the good to a higher level (PR in the diagram). In fact, the yellow area, which we previously included in the consumer surplus, is now associated with “hidden costs”. As these costs will not go to the supplier (as he still sells as the price PC) and are thus lost similarly to the red area, the overall surplus of all market participants will be further reduced.

The discussed textbook example shows that price controls are in general not a good instrument to regulate the market, as they are associated with economic losses. While the current regulations in the specific case of Belarus (see Chapter 3) do not set a stiff price ceiling but rather limit the monthly price growth by a certain percentage, they still imply that the price in the regulated market will be lower than it would have been without regulations – all negative implications attached. Especially in the case of imported goods such as medicine, where prices are highly dependent on the exchange rate developments, a price ceiling is likely to lead to a shortage as producers/distributors would incur losses by selling at the lower price.

Conclusion 3: A standard microeconomic analysis of price ceilings demonstrates that they lead to an overall decrease in welfare. As they are likely to lead to shortages of the goods in question, several negative implications follow.

5 Conclusion

Belarus is currently faced with high inflation, which has moved beyond the target of 5%. Due to the many economic and social problems associated with inflation, the authorities should rightly focus their attention on the fight against it. However, lowering inflation should be done with the right instruments; otherwise, the objective will not be reached and additional economic problems (implying welfare losses) appear. This is the case when using administrative measures to fight broad-based inflationary pressures, which are better suppressed by standard macroeconomic tools like tight demand-side policies (monetary and fiscal/income policies).

If the objective is to protect consumers' purchasing power (especially during the pandemic), the authorities should use targeted social assistance to support low-income households rather than introducing price ceilings. Likewise, effective competition in all sectors of the economy will ensure that companies do not earn excessive profit margins and contribute to affordable prices for consumers.

Annex

Table A1. Socially important goods

1. Freshly frozen fish in carcasses (carp, cod, herring, mackerel, and Argentine family), excluding fish products and articles of fish, fish fillets.
2. Canned fish, except caviar, canned sturgeon, salmon, anchovy, tuna, eel, fish liver, canned fish: natural canned herring, mackerel, horse mackerel and other species and natural canned fish with oil (mackerel, horse mackerel, carp, etc.); In oil (sprats, sprats, sardines, saury, mackerel, herring, mackerel and other types of blanched, dried, smoked, fried oceanic and freshwater fish); in jellies; in tomato sauce (partially cooked, from herring, cod, mackerel, carp and other species, in the form of carcasses, pieces, minced meat); canned pâtés; canned fish in marinade (canned fried fish of all kinds in marinade).
3. Meat (beef and pork (including bone-in), chicken meat including broiler chickens): Beef in halves and quarters (excluding high quality beef) and pork in carcasses and halves, sold by grade, in accordance with the standards for cutting these types of meat for retail sale; cuts and large lumps of boneless meat and meat boneless natural half-finished products from beef and pork with the exception of large lumps of boneless meat half-finished products from high value parts of beef and pork - loin, long muscle, sirloin and neck parts, high-quality beef and also large lumps of boneless meat half-finished products of other names from the specified parts of carcass; Chicken meat, including broiler chickens, chilled or frozen, in carcasses or as parts thereof - halves, quarters, thighs, shanks, thighs, wings, breasts, soup sets, etc., excluding fillets and minced chicken.
4. Cooked sausage products: cooked sausage products of various shapes, made from a mixture of ground meat and non-meat ingredients, formed into casings, heat-treated until ready for consumption, of the highest, first, second, unvaried, meat-grinding varieties.
5. Pasteurised cow's milk, cow's milk kefir, sour cream, cottage cheese of any fat content, in any package, without flavourings, except pasteurised, sterilised, melted milk, sour cream or sour cream containing vegetable fat, curds, cheesecakes, curds, desserts, granulated curds with added cream
6. Cheese (hard, semi-hard): Rennet (fermented) hard and semi-hard cow's milk cheeses in weights and packages, except extra hard, melted, smoked, musty, brine, with additives, cheese products.
7. Sunflower and rapeseed oil, except blended oil and deep-frying oil.
8. Butter made from cow's milk or cream, except for dessert butter, chocolate butter, fruit butter, other fillings and clarified butter.
9. Fresh diet or table hen egg.
10. Wheat flour (by weight or packed, highest grade, first and second grade, no additives).
11. Rye and rye-wheat bread, except for breads with grain, fruit and vegetable additives, nuts, dried fruits, spices, dry wheat gluten (wheat gluten), vegetable oil.
12. Bread, bakery products (loaf) of wheat flour, except for bread and bakery products with grain, fruit and vegetable additives, nuts, dried fruits, spices, gluten dry wheat (wheat gluten), dairy and egg products, toast loaves, bread (crisp, grain, extrusion and others), lavash and other national bread, bakery products.
13. Dry pasta without durum wheat flour (pasta, vermicelli, spaghetti, rolls and other dry pasta falling into groups B and C), except instant pasta).
14. Oat flakes without flavouring and other additives (by weight and in prepacks).
15. Ground white rice, semolina, millet.
16. Fresh food potatoes, fresh table beetroot, fresh table carrots, fresh cabbage, fresh onions, fresh cucumbers and fresh tomatoes.
17. Fresh apples.

Source: Regulation No. 83 of 28.12.2020, amended by Regulation No. 9 as of 10.02.2021 and again amended by the Regulations No. 19 as of 26.03.2021 and most recently by No. 48 as of 29.06.2021.