

Welfare Costs of Inflation in Russia

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Abstract

The question of the optimal monetary policy is central to monetary economics. Many models imply that the optimal policy is contractionary with nominal interest rates near zero. By now there is a large literature, which provides estimates of the welfare costs of inflation based on application of those models. Here we take some versions of the partial equilibrium model of Imrohoroglu (1992) and of the general equilibrium model of Aiyagari (1994) and compute welfare costs of inflation in the Russian economy. We find that partial equilibrium estimates are consistent with conventional view that contractionary policy is welfare improving, however our general equilibrium estimates imply positive optimal inflation of about 5% per annum. That finding owes to the presence of the Tobin effect and distortionary taxes (in addition to heterogeneity in asset holdings in the partial equilibrium models), which are known to produce deviations from the Friedman rule.

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