INTERVIEW-Russia must reform or growth will taper off-IMF

By Lidia Kelly

MOSCOW, Sept 21 (Reuters) - Russia must make fundamental changes to its fiscal and monetary policy in the next few years or face slower, more volatile economic growth that falls far short of its potential, a senior International Monetary Fund official told Reuters.

To achieve annual economic growth of up to 6 percent the government needs to cut its non-oil budget deficit to 4.7 percent of gross domestic product by 2015, Odd Per Brekk, the IMF's resident representative in Russia, said in an interview.

Yet the government has suspended that medium-term goal and now targets a deficit -- after stripping out energy revenues -- that will remain over 10 percent of GDP over the three-year planning horizon in Finance Minister Alexei Kudrin's budget.

The central bank must also switch to targeting inflation as its sole policy focus, moving away from managing the rouble's exchange rate; an approach that amplifies external shocks driven by oil price swings and volatile capital flows.

It should cut its medium-term annual inflation target to a range of 3-5 percent - compared to the central bank's 2011 target of below 7 percent, Brekk said.

"If you don't come to grips with instability, you are not going to get the investment that you need for realizing your growth potential and for stability and diversification," he said.

"If you continue the policies of the last decade you're likely to have growth tapering off to 3.5-4 percent over time, you will have a less diversified economy, more vulnerable to external shocks, less buffers to withstand those shocks."

On Tuesday, the IMF cut its 2011 GDP growth forecast for Russia to 4.3 percent from previous 4.8 percent and next year to 4.1 percent from 4.5 percent [ID:nW1E7JU00B]

INSTABILITY

The Russian economy, where nearly half of federal revenues and two-thirds of exports are accounted for by energy, has grown on average at a rate of just over 5 percent in the past decade. But that growth has been volatile, Brekk noted.

"The Russian economy for the past 10 years has shown a much greater degree of macroeconomic instability than countries that you would like to compare it with," he said, referring to the other 'BRIC' countries -- Brazil, India and China -- eastern Europe and commodities exporters like New Zealand and Australia.

Part of the instability comes from Russia's dependence on oil and its high export concentration by commodity. "You have a vulnerable structure, but on top of that economic policies have played a role," Brekk said.

"Both, fiscal policy and monetary policy have contributed to the instability over the past decade. And on both, the fiscal policy front and the monetary policy front, you need firmer anchors."

MORE AMBITIOUS FISCAL POLICY NEEDED

The IMF recommends "a more ambitious but also a more growth-friendly" fiscal consolidation. Taxes need to be reformed, without raising rates, while subsidies and tax breaks should be curbed, Brekk said.

"There's a fairly substantial scope for raising revenues without raising tax rates in the sense that you can improve tax administration, you can reduce exemptions," he said.

But fiscal policy alone will not assure Russia's path to stable growth, Brekk said.

"You also bring inflation down through successful inflation targeting, you do get the banking system on firm footing and you also deal with some of the structural reforms," Brekk said.

To help achieve a lower inflation goal, the central bank should streamline its range of interest-rate instruments, setting a single effective policy rate as its primary policy goal.

"The issue is really about focusing on inflation, having a monetary policy focused squarely on inflation and not on other things," Brekk said.

(Writing by Lidia Kelly, Editing by Douglas Busvine)