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**SOVIET
MONEY AND FINANCE**





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SOVIET MONEY AND FINANCE

BY

L. E. HUBBARD



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PREFACE

THIS study of Russian finance, though confined to a limited and recent aspect of Russian economic development, is the fruit of a long-standing and general interest in the country. My personal acquaintanceship with Russia goes back over thirty years, but my interest antedates even this, since my family connection with Russia began at the beginning of the nineteenth century, when a forebear founded a business in St. Petersburg for the export of Russian tallow, timber, grain and other raw materials to the United Kingdom. Since the Revolution I have studied closely the development of the Soviet Union, more particularly after the first Five-Year Plan opened in 1928. Twice within the last six years I have paid extended visits to the country, the first with the object of forming an opinion of the real significance of the Plan, and the second with a view to making a special study of the monetary and finance system. I may, I think, claim to possess a certain background as well as a fairly good knowledge of post-revolutionary Russia.

In addition to information gained by personal observation, contacts and conversations with officials of the Soviet State Bank, I have drawn upon *Sovietaki Kredit*, published in 1933 by the State Financial Publishing Department, for much material on banking methods, credit planning, accounting, etc.; I also found *Vnoutrennyaya Torgovliya S.S.S.R.* (the Internal Trade of the U.S.S.R.), published in 1935 by the State Social-Economic Publishing Department, useful in

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explaining the Soviet conception of the function of money in a system of socialised distribution; and generally I have closely studied Soviet newspapers and pamphlets for current economic legislation, the speeches of Soviet leaders and letters from correspondents, which are often extremely frank in disclosing defects in the financial system.

There was possibly a more complete break between the pre- and post-revolutionary monetary and financial systems than in any other branch of economic life. The old system was almost completely destroyed during the period of War Communism, so that the Soviet Government had to re-create the very groundwork of a new monetary and financial system. It seemed unnecessary, also, to go behind the Bolshevik Revolution for a starting point, because banking and finance in Imperial Russia did not differ in main principles from Western Europe.

I have divided this book into three Parts. The first gives a short historical survey of the evolution of Soviet finance from the Revolution to the present time, together with an account of the successive stages in the development of industrial organisation and administration. The second is devoted to a more detailed description of the present methods and organisation of banking and credit and an explanation of financial policy and theory, with an outline of the organisation of distribution, transport and collection of agricultural produce. Certain chapters in this Part were originally published in Russian Monograph No. 4/5 of the School of Slavonic and East European Studies. The third Part consists of a critical and analytical study of Soviet financial theory and practice.

The great interest in the Soviet financial system is

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the attempt to design a system that shall meet the requirements of a socialist and planned economy and the way in which money functions and behaves in such an environment. I have attempted so far as possible to show how the system works. Since money was made an object of planning, experience has revealed several errors in earlier Soviet theory and has proved that in a socialist economy money still has many of the same qualities and reactions as in a capitalist economy. But many shifts and compromises will be made before a final solution of the problem is found. The most that can be said at the moment is that a national economic structure based on socialism and planning has proved capable of existence; whether it will ever prove more efficient, more equitable and intrinsically an improvement on economic systems based on private ownership and enterprise remains to be seen. It is, perhaps, significant that many of the more extreme socialist economic theories have in practice proved impracticable and compromises with old and proved capitalist principles have had to be adopted.

L. E. H.

April 1936

The word "capitalist" is used throughout this book to denote the opposite to socialism; that is, an economy based on private enterprise, open markets and prices fixed by supply and demand.

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INTRODUCTION

ON 7th November 1917 (24th October, Old Style) the Kerenky Government fell and was succeeded by the Revolutionary Soviet under Lenin. By the end of 1935, after eighteen years of Soviet Government, Stalin alone of Lenin's closest comrades and helpers in the October Revolution held a dominant position in the Soviet Government and Communist Party.

During the eighteen years which saw the extinction of so many old militant revolutionaries and the rise of new men in the administrative and economic councils of Soviet Russia there were inevitably a number of changes in the economic structure and organisation of the country. These changes were largely due to a continual conflict between the revolutionary theories of the Bolsheviks founded on the doctrine of Marx and Engels, and the irresistible force of natural laws and the conservatism of human nature. The end of the struggle is not yet in sight, and it is not my intention to analyse and evaluate the successes and reverses of the Bolshevik experiment. I use the word "experiment" advisedly, for all efforts to achieve a desired end are experimental until that end is finally achieved or abandoned, and the final aim of Bolshevism is full and complete communism in the widest sense of the word. It seems, however, that the first stage towards communism, the realisation of state capitalism and the elimination of private ownership of the means of production and distribution, has been completed. Whether this condition of socialism will eventually develop into

full communism remains to be proved, but it is likely that a long period for the consolidation of the position gained must elapse before a further advance can be made.

In the course of its socialist evolution the country has passed through a number of distinct and fairly well-defined economic phases which, briefly enumerated, were:

(1) A short initial period of some eight months from the October Revolution to the beginning of War Communism, during which the revolutionary Government instituted a state monopoly over many staple commodities, notably over corn and bread. Private owners having been expropriated, industry and wholesale trade were taken over by workers' councils. Retail trade remained largely in the hands of private traders; to a less extent the distribution of the necessities of life was conducted by consumers' co-operatives.

(2) War Communism, which may be said to have started with the official nationalisation of large-scale industry in June 1918 and lasted till the decree of August 1921 introducing the New Economic Policy. A tentative experiment was made to abolish money. Private trade was forbidden and the consumers' co-operatives were reorganised and placed under the Commissariat of Supplies, the necessities of life being distributed among the urban proletariat by means of a system of ration cards.

(3) The period of restoration which succeeded War Communism and lasted till 1927. This period is practically synonymous with the New Economic Policy decreed in August 1921. Private enterprise received a new lease of life, and during the first part of this phase was the predominant factor in the distribution of

consumption goods. Trade, which since the Revolution had degenerated to little more than local barter, revived, and goods were bought and sold and transported to distant parts of the country. In the latter part of this phase state and co-operative distribution began to oust the private traders, who were handicapped by heavy discriminatory taxation. The open market which had been allowed to develop under the N.E.P. was gradually circumscribed, the exchange of goods between state organisations being increasingly conducted at arbitrary fixed prices in accordance with the Government's economic plan. At the same time the Government began to requisition the peasants' crops at its own fixed prices instead of buying at market prices.

In 1921 the State Bank was established and in 1922 it received a charter to issue the new chervonets currency backed by a gold reserve. Up to 1924 the new bank currency and the old Soviet paper currency circulated side by side, the latter continually depreciating in terms of the chervonets. In 1924 the old paper rouble notes were redeemed at an enormous discount by a new issue of government rouble notes interchangeable at parity with the bank-note issue.

(4) The period of reconstruction and development, which opened in 1927 with a sort of preparatory stage for the first Five-Year Plan. Increased pressure was brought to bear on private trade, which, through taxation and even more direct methods, was gradually squeezed out of existence. By 1931 private enterprises in industry and distribution had to all intents and purposes been exterminated.

The extermination of private trade compelled the State to assume the responsibility of feeding the

industrial proletariat. In view of the rapidly increasing urban population and its food requirements, the Government was compelled to resort to measures of virtual confiscation to obtain the necessary supplies from the peasants. Rationing, first in respect of bread and later extended to most articles of everyday consumption, was introduced in 1929 and was followed by the institution of so-called "closed" shops for the sale of goods to specified classes or groups of the urban population.

Up to 1931 the co-operative system had predominated in retail distribution, the Government having concerned itself mainly with the development of industry and the wholesale exchange of commodities. But in 1932 the Government began to take an increasing interest in retail distribution and extended its operations in competition with the co-operatives, which rapidly declined in relative importance and power. In 1931 an experiment was started by the Government in establishing so-called "commercial" shops, which differed from the existing co-operative and state retail organisations in selling goods without restriction at prices much higher than the prices charged for rationed commodities in the "closed" shops.

(5) A period beginning on 1st October 1935 with the derationing of all foodstuffs and most industrial consumption goods. From this date money, which, during the time the distribution of consumption goods was regulated by rationing, had a varying purchasing power depending on the category of its possessor, became the sole standard of wages. Retail prices were fixed to equalise supply and demand. During 1935 a more liberal policy towards the peasants and other sections of the population outside the privileged proletarian

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workers was inaugurated, and while there was no relaxation of the ban on private enterprise, a greater tolerance was evinced by the Government and Communist Party towards the accumulation and enjoyment of personal property.

PART I

CHAPTER I

THE EVOLUTION OF MONEY UNDER SOCIALISM

ACCORDING to MARX, a community in a state of complete communism does not require money; in fact, complete communism and money cannot exist together. The ultimate aim of the Revolution was a communist and moneyless State, but it is now acknowledged that this can be realised only in a very dim and distant future. There are at least two prerequisites: one is such a change in human nature that the individual will willingly give the best of his ability in return for the satisfaction of his legitimate needs, and the second is the production of wealth in such a degree that it is unnecessary to discriminate in distribution between individuals of higher and lower ability.

The preliminary stage to communism is socialism, in which private ownership of the means of production and distribution is abolished and in which it is impossible for the individual to accumulate capital. A socialist state cannot dispense with money, though the nature and functions of money differ in some respects from those in capitalist states.

The mechanism for effecting the distribution and exchange of goods and services in the U.S.S.R. is the rouble currency, the most conspicuous difference between which and capitalist currencies is that the former is solely an internal currency entirely independent of world exchanges and world prices. The external

trade of the Soviet Union is a state monopoly and is conducted exclusively in foreign currencies, though for statistical purposes the value of imports and exports is denominated in gold roubles. There is, however, nothing in common between the gold rouble and the internal paper rouble. Soviet paper currency, both bank and treasury notes, are inconvertible paper and are essentially a fiat currency, but not a managed currency in the sense that the conditions of issue are managed in such a way that the rouble shall possess a determinate value in terms of any objective standard.¹

It was inevitable that, in the successive stages or phases of Soviet economic and social development since the Revolution, the functions, and to some extent the nature, of money should have undergone changes.

When the Bolsheviki first seized power the distributive system throughout the whole country was in a state of chaos and the preoccupation of the new leaders with political matters precluded any serious attempt to reorganise trade. The revival of private enterprise in the period of the New Economic Policy did not, as was thought at the time, signify the abandoning of the programme of socialisation. It was merely a temporary halt on the road to allow a breathing space, for the unfortunate results of War Communism had shown that the transformation of a country's circulatory system from private enterprise to a socialist system required long and careful preparation.

It was, in the opinion of the Soviet leaders, necessary to destroy the old system before building up the new

¹ At the close of 1935, when the principle of rationing in retail distribution was abandoned and demand limited by the operation of prices, it was recognised that the issue of currency would need to be regulated if prices were not to fluctuate.

one. The inflationary increase in the note circulation between 1917 and 1921 was, in fact, only a continuation of the process that had begun under the Imperial Government during the War. According to some versions of the early Soviet economic policy, the original idea was to continue printing currency until Soviet notes possessed absolutely no value and thus allow money to achieve a sort of suicide. But it is improbable that all the leaders agreed with this notion. Lenin apparently held the view that the purchase of food-stuffs from the peasants with irredeemable and depreciating paper was the only effective way of persuading them to make a "loan" of food to the Bolsheviki. He fully appreciated that what the peasants received in return for their produce represented no immediate counter-value, but his use of the word "loan" seems to indicate that he intended at some later date to give this paper a certain purchasing power. When in 1924 the original Soviet paper roubles were at last redeemed, the rate at which they were convertible was fixed at 50 milliards for one gold rouble. This meant, in practice, that the peasants never received any tangible value for the food they had sold to the Red Army and the workers up to 1921.

The inflation also effectually dissipated any private capital in the form of money. Fixed capital in the form of land and industries had long been nationalised. When private enterprise again became legal under the New Economic Policy, only those who possessed capital hidden away in the form of gold or foreign currency, or those handicraftsmen whose little workshops and plant were too insignificant to be nationalised, could take advantage of the new system.

During the first part of the N.E.P. or restoration

period a stable currency was essential to the revival of internal trade. The Government had not had time to develop a state distributive system, neither was it able to produce a sufficient supply of consumption goods in the factories it had taken over from the former owners. It was compelled, therefore, to tolerate private enterprise in the production and distribution of consumption goods until it could undertake to supply the population with the products of state enterprise distributed through state trading organisations. This called for a free market and a stable purchasing medium, particularly to facilitate the exchange of manufactured goods for the foodstuffs of the peasants. In these circumstances Soviet money regained to a considerable extent the quality of capital; that is to say, the private producer or trader could make profits and save money for reinvestment in his business, to employ more labour, buy simple machinery or tools, or increase his trading turnover. In the open market, therefore, the rouble had a purchasing power dependent on commodity prices as determined by supply and demand. But in the socialised sector of the national economy, that is, as a medium of exchange between state enterprises, the rouble was essentially only a unit of account. During the N.E.P. period money thus possessed a dual character: outside the socialised sector it had all the qualities of a medium of exchange operating in an open market; within the socialised sector it was a unit of account in which arbitrary values were expressed. As a medium of exchange between the socialised and non-socialised sectors the rouble at first functioned in conditions more or less of an open market, while in the latter part of the period its behaviour much more closely simulated that in the socialised sector. At the

beginning of the N.E.P. period the exchange of country produce for town manufactures was predominantly in the hands of private traders. These had to pay the price demanded by the peasants for agricultural produce and this price depended on the price the peasants had to pay for manufactured goods. Meanwhile the nationalised state industries bought much of their raw material (cotton, flax, wool, hides, etc.) from the peasants at the current market price and sold their finished goods to the co-operatives and private traders also at prices determined by market conditions. State industry at this time was very largely engaged in producing for the market. But the Bolshevik conception of trade, or rather the distribution of goods, is utterly antipathetic to the capitalist idea of a market. Though the principle of producing goods for sale in the open market is contrary to the Bolshevik doctrine, in a highly complex industrial economy the exchange and distribution of commodities in kind is impracticable; some token of exchange in which value can be expressed is necessary; if, however, this looks like and is called money it must not be allowed to become a standard for market values.

By 1926 the Soviet Government had increased nationalised production and extended socialised distribution to a degree that enabled it to resume its campaign of exterminating private enterprise. On equal terms state enterprise proved incapable of competing with, much less undercutting, private enterprise, but by imposing high taxation on private enterprise and by withdrawing supplies of raw material and finished goods from the market the private manufacturers and merchants were gradually squeezed out of existence. By the beginning of the first Five-Year Plan in 1928 it was impossible

for a private citizen to purchase any means of production, such as a building or machinery or raw material, and very nearly impossible to obtain finished goods for resale. In fact, to do so was a crime and so-called speculators were heavily punished. Money had therefore lost the quality of capital; so far as the individual citizen was concerned, it was only a means of satisfying his personal day-to-day wants.

Meanwhile the Government had found itself strong enough to force the peasants to sell their produce at its own price. Since manufactured goods were supplied from state enterprises through the state-controlled consumers' co-operatives, their prices were arbitrarily fixed. The Government's standpoint was that if it paid the peasants at fixed rates and sold them manufactured goods at fixed rates it was able to control distribution and consumption. The return received by the peasants for their labour was therefore decided by the Government, which thus was able to ignore the prospect of chance price fluctuations in making its plans. The same principle applied *pari passu* to the wages of industrial workers.

By 1928, about the beginning of the first Five-Year Plan, the distribution of consumable goods had become a function of state planning, the open market having been supplanted by a system of controlled prices. Had practice coincided with theory, the amount of money distributed by the Soviet Government in wages and payment for agricultural produce should have been just sufficient to effect the purchase at fixed prices of the volume of consumption goods made available by the State. But in order to avoid a big rise in retail prices rationing had to be resorted to. There was, in fact, an excessive issue of purchasing medium, the reason for

which will be discussed in detail later on. Undeniably theory had broken down, and the explanation seems to be that while the Soviet planning authority was able to fix arbitrary prices for inanimate goods, it was incapable of fixing arbitrary rates for animate labour if this involved a reduction in money wages. In other words, labour still retained some power of bargaining, though there was, of course, no free labour market. The results of this discord between theory and practice led to various difficulties, and eventually, in 1935, a workable compromise was reached, rationing being abolished and retail prices being fixed at a level which equalised supply and demand. Whatever excuses and explanations may have been given for this change of policy, it was unquestionably a retreat from the original position; namely, that in a fully socialised system prices can be arbitrarily fixed without reference to supply and demand. In the phase of Soviet economic history which began with the abolition of rationing, money regained a large part of the prestige and ascendancy it lost during the period characterised by rationing.

CHAPTER II

REVIVAL OF BANKING

§ 1. THE EVOLUTION OF CREDIT UNDER THE SOVIET RÉGIME

THE entire banking system of the country was nationalised on 13th December 1917, and within a short time all large-scale industrial enterprises, land belonging to the Crown, corporations and individuals—except the peasants—external trade and the stocks of all considerable merchants were also nationalised. Thus practically all bank assets in the form of securities, commercial bills and other claims were automatically extinguished. Deposits were not officially sequestered, but the amount that could be withdrawn at any one time was limited. However, the rapid depreciation of the paper rouble, due to the floods of notes printed by the new Government, soon rendered any remaining balance worthless. In such circumstances credit disappeared and the banks soon ceased to make any pretence of doing business. The former Imperial State Bank alone survived for the purpose of putting into circulation the “Sovsnaks” (Soviet tokens), as the paper notes printed by the new Government were termed. In a very short time the Revolution succeeded in destroying the whole of the former financial system and mechanism. When the New Economic Policy was inaugurated in 1921 the Soviet Government was faced with the task of creating an entirely new monetary and credit system.

In the summer of 1921 an inter-departmental budgetary conference was faced with applications for loans from state institutions. A project for organising a special Banking Department of the Finance Commissariat was drawn up, and as a result the new State Bank, later known as the "Gosbank", was established in October of the same year. The functions of the bank were defined as "to organise and adapt credit and other banking operations to the development of industry and the exchange of commodities with the agricultural population, as well as to concentrate monetary transactions and take other steps for introducing and establishing a true currency circulation".

During the chaotic times of War Communism and civil war the output of industry had fallen to a small fraction of its pre-War capacity, markets had been disorganised and the mechanism of retail trade practically disappeared. The industrial enterprises, which were still manufacturing, had mostly given up any attempt at calculating costs of production and keeping accounts of any sort. The bank's first task was to attempt to recreate some sort of business discipline. At the beginning it could undertake only the financing of light industries, such as sugar and textiles, and the export activities of the timber industry, because such loans were immediately reproductive. Heavy industry, which naturally required loans for considerably longer terms, was financed to some extent by the Government out of budgetary revenue. Until the introduction of the stable chervonets currency at the end of 1922, and indeed for some little time afterwards, the rouble currency continued to depreciate, and under such conditions bank deposits by independent enterprise were

bound to be insignificant. The funds at the disposal of the bank for extending credits consisted almost entirely of government deposits and budgetary grants. The need of a stable currency had early been recognised by the Government, for the conference of the Communist Party held in December 1921 had resolved that the restoration of a currency based on a metallic cover was the first step towards reconstructing a market, without which it would be impossible for large-scale industry to be quickly re-established.

The introduction of a firm and stable currency was immediately followed by a rapid development in the banking and credit system. Enterprises could now begin accumulating capital for reconstruction, extension and development. With the growth of deposits the credit methods of the bank underwent a change. During the period of inflated and depreciating currency, bank credit was principally granted in the form of advances against goods. Some attempts had been made to introduce a system of discounting credit instruments under a sort of gold clause—providing that the amount to be repaid was to be the equivalent in gold of the amount lent—but without very much success. A stable currency, however, brought ordinary commercial bills back into favour, and in fact the Gosbank encouraged their use mainly for the reason that when advances were made against goods repayment at a fixed date could not easily be enforced and the system resulted in the turnover of goods being possibly delayed and certainly not expedited, whereas a bill payable at a fixed date constrained the payer to resell the goods purchased as quickly as possible in order to meet his bill.

So great was the effect of the New Economic Policy

on the expansion of trade and industry that it soon became clear that the needs of thousands of separate enterprises, both large and small, could not be covered by a single bank. Therefore in 1922 a considerable number of new banks were created to meet the economic requirements of the country. Among the first to appear on the scene was the Bank for Consumers' Co-operatives, which opened in February and in the course of the next couple of years had spread its branches into almost every province and region of the country. In August the Industrial Bank was formed and in November the Moscow Municipal Bank, the first communal bank in the Soviet Union. Following these came the Electro Bank, formed with the special purpose of financing the development of electric power, and the Bank for Foreign Trade. Over all these banks the Gosbank held a sort of supervisory position, mainly to see that there was no overlapping and competition. The credit needs of the peasants were to some extent provided for by a system of mutual credit co-operatives with capital consisting of sums contributed by the peasants themselves. The first of these mutual credit associations was formed in Leningrad in June 1922, and by 1925 the number had risen to 176. Their activities, however, were restricted, for their total funds then only amounted to 59.3 million roubles. This is accounted for by the fact that their resources were almost exclusively drawn from private depositors and consequently they had to pay far higher interest to attract money than the State Banks. While the Gosbank paid 8 to 10 per cent on deposits, the mutual credit associations were paying 36 per cent or more.¹

About the end of 1925 there existed, besides the

¹ *Soviet Credit*, 1932, Part I, p. 42.

Gosbank, five so-called Central State Banks, the Industrial Bank, the Moscow Municipal Bank, the Central Co-operative Bank, the Electro Bank and the Bank for Foreign Trade. Their relative importance, compared to the Gosbank, may be judged from the fact that their total deposits on current account amounted to 487 million roubles against the Gosbank's 421 millions, while the total of the Gosbank's balance-sheet was three and a half times the aggregate balance-sheets of all the others. Nevertheless, these banks were doing useful work in accumulating and concentrating the liquid funds of state enterprise and by acting as distributing agencies for the State's budgetary grants. At this time they were still providing short-term credit, although gradually they were concentrating more and more on providing capital investment funds.

At the end of 1925 the five central banks had nearly two milliard roubles' credit outstanding, of which nearly 50 per cent had been granted to state industry and about one-third to state trading concerns and co-operatives. About half the total amount of bank credit was on long term. An interesting movement had also taken place in the form under which credit had been granted. In 1923 bill discounts amounted to about 19 per cent of total credit operations and advances against goods to 17.5 per cent. By the end of 1925 discounting had increased to 32.4 per cent and advances against goods had fallen to 11.5 per cent.

By 1926 a banking system had been built up which was more or less proportionate to contemporary requirements. The money shortage had been overcome and nearly every enterprise had sufficient liquid funds for its ordinary needs. In fact it is noteworthy that

the current accounts at the five banks actually fell from 488 million roubles in 1924 to 320 million roubles in 1927. In the Industrial Bank alone the fall had been 182 millions to 60 millions. The reason for this was that enterprises were beginning to carry out plans of reconstruction and of capital development and were drawing on their own balances for the purpose. With the growth of state enterprise, which had swallowed up or displaced most of the private enterprise existing at the beginning of the N.E.P. period, central planning became a need and a possibility. Under a system of central planning the existing credit system appeared too complex, and an important law was passed on 29th June 1927 laying down the principle that every state organisation must keep its cash balances at, and obtain credit from, a single bank, while every bank's active and passive operations were to be regulated by a Banking Committee set up in the People's Commissariat for Finance. The allotment of enterprises to banks and the distribution of different credit activities to different banks resulted in the Gosbank being charged with the duty of giving short-term credit to:

- (a) Other credit institutions.
- (b) Financing the state collections of grain and raw material.
- (c) Transport.
- (d) Trading organisations of national or republican importance.
- (e) The larger industrial enterprises and the larger co-operative enterprises.

As a result of the reorganisation, the Industrial Bank's short-term credit operations were practically abolished. This decree was a very important step towards making

the Gosbank the only institution for granting short-term credit. Whereas in 1924 it had granted 76.5 per cent of total short-term banking credits, by the end of 1928 it was granting 94 per cent. By a decree of February 1928 the short-term operations of the Industrial and Electro banks were entirely handed over to the Gosbank. The short-term crediting of agricultural trade had already been taken over by the central institution, while the Central Co-operative Bank as a short-term institution had never had any great importance. The communal banking system, which had been almost exclusively short-term, had gradually become more and more converted to long-term financing. The reorganisation of the banking system also resulted in short-term credit being provided almost entirely by bank deposits, while the chief source of long-term credit remained, as before, budgetary grants. One rather unfortunate attempt was made to issue a loan on capitalist lines to procure funds for long-term capital investment. This was in 1925 and for an amount of 300 million roubles. The bonds were allotted by the Finance Commissariat among different state organisations rather in the form of a levy or tax. Actually a nominal amount of 245 million roubles was issued, but the bondholders mostly promptly pledged their bonds as security for advances from the Gosbank, which so became the real subscriber to the loan.

In 1926 a bank for long-term loans had been formed as an offshoot to the Industrial Bank. Its funds consisted of a percentage of the profits of the Industrial Bank, money realised by client enterprises from the sale of surplus immobile assets and unimportant levies on the profits of industrial enterprises. Its chief source of loanable funds afterwards became budget appropria-

times. The question whether long-term credits were to be given in the form of interest-bearing repayable loans or as grants remained undecided for some time. Up to 1926 budgetary grants were nominally repayable, though, as a matter of fact, not a single enterprise actually made any repayment to the Finance Commissariat. This, however, was not the fault of the enterprises themselves, for repayment should naturally have been provided out of profits. But before repayment could begin, the Five-Year Plan had come into operation, laying down exactly how profits were to be distributed, and in this distribution repayment of loans was not included. Therefore, as a general rule, budgetary appropriations were given in the form of unrepayable grants. Loans granted by the bank from its own and borrowed resources remained repayable. During 1927-28 various steps were taken in addition to those noted above, all in the direction of concentrating short-term credit in the Gosbank and long-term credit in the special banks, whose fields of activity became strictly confined to particular classes of state, co-operative and municipal enterprises.

§ 2. THE PRINCIPLES OF SHORT-TERM CREDIT

During the first part of the N.E.P. period—that is, roughly, from 1922 to 1925—the relations between the producers of raw material and manufacturing enterprises, and between these and the selling and distributing organisations, were comparatively free. Prices were strongly influenced, if not completely determined, by supply and demand, and buyers and sellers had much more freedom of choice in finding markets than they were to enjoy later under the Plan. In such

circumstances the commercial bill—which had reached a fairly high and rather peculiar development in pre-War Russia,¹ and was therefore not a new thing—was admirably adapted to the trading needs of the country. Bills given by state or co-operative enterprises for goods bought from other state or co-operative enterprises were discounted or lombarded by the Gosbank in much the same way as before the War. Gradually state enterprise became more and more centralised. The purchasing of the raw-material requirements of one industry was centralised in the syndicate, which obtained its supplies from the syndicates of the industry or industries producing the raw material. In many industries raw material in process of manufacture is handled by several factories, each specialising in one or more processes. To finance the passage of the raw material through each stage the industry as a whole, in agreement with the Gosbank, could apply the so-called “Conveyor” credit system. Briefly, this meant that as each factory received the raw or partly manufactured material it received a credit to repay the factory from which the material was received; in other words, credit was transferred automatically from one factory to another simultaneously with the delivery of the goods. Thus the principle of commercial credit, in the sense that the buyer is the debtor of the

¹ In pre-War Russia cash sales were rare. The merchant bought from the manufacturer on 3, 6, 9 or 12 months' credit, giving a bill or rather a promissory note for the sum due. The length of credit was very often determined by the number of times in the year that the merchant visited Moscow or other centre to replenish his stock. On every visit he would bring the necessary cash to redeem the bills of the previous visit. If the manufacturer required cash he could lombard his bills at his bank. Discounting was little practised, since the banking organisation for collecting bills in the provinces was but poorly developed. The law rather favoured the small defaulting debtor.

seller, was substituted by the principle of bank credit, in which the buyer is the debtor directly of the bank. This system at first was applied mainly, if not entirely, to the movement of commodities within a single industry, while the system of commercial credit, involving the use of bills, continued to prevail in trade between independent organisations.

The "Conveyor" system held the germ of the credit reform of 1930. It was clear that bank credit to the purchaser to finance specific purchases of goods was better suited to the theory of planning than the commercial credit, which was more susceptible to abuse. The decree of 30th January 1930 did not, therefore, make a sudden and complete break with the old system. It abolished the system of commercial credit, which had for some time been losing favour, and established as the sole method the system of bank credits which had been increasingly practised for some time past. It did not follow, however, that because the new system had worked well when applied to transactions between units of the same organisation it would work equally satisfactorily in a much larger field, and numerous amendments to the original law were necessary before it could be said to operate efficiently.

When the Five-Year Plan in 1928 undertook to fix the production programme of all industrial enterprises, it followed that a credit plan had also to be drawn up to fix the maximum amount to which any enterprise could be in debt to the bank. The Plan not only fixed the output of every enterprise but also prices of raw material and finished goods, costs of production, etc., and therefore theoretically the framers of the Plan should be able to determine the approximate credit requirements of every manufacturing and trading enterprise.

The idea originally prevailed that the Gosbank need not concern itself with the solvency of its clients; its function was to keep their accounts and issue credit automatically, so long as the Plan was not infringed. Under this system, manufacturing enterprises had only to supply proof to the bank that they had forwarded a consignment of goods to draw the corresponding credit. This system, not surprisingly, proved far too loose and led to all manner of abuse, since there was no effective check on production costs nor on quality, and therefore on actual expenditure and receipts.

Neglect to carry out the spirit of the credit reform led to the automatic issue of bank credit and relieved state enterprises of any urgent necessity to regulate their finances, with the result that the Gosbank practically went over from a system of granting credits repayable at a fixed maturity to granting non-repayable loans. Enterprises, therefore, ignored their financial position and that of their own clients, and undertook liabilities which they had little or no prospects of meeting. In addressing a congress of industrial and business leaders on 23rd June 1931 Stalin said:

“Thanks to the unbusinesslike way in which affairs have been conducted, the principles of economic accountancy have been entirely ignored in a whole range of our enterprises and economic organisations. Many enterprises and organisations have long ago ceased to keep accounts, make estimates or draw up statements of income and expenditure.”

In January and March 1931 two decrees were issued introducing a system whereby enterprises were to draw on their planned credit quota at the bank to

finance their purchases of raw material, etc. As a general rule delivery could not be obtained until the supplying enterprise had received payment for the goods, and thus in theory bad debts were to be eliminated. The bank meanwhile was supposed to grant credit only when satisfied that the borrower was genuinely entitled to it under his credit plan. (A detailed account of credit planning is given in Chap. VI.) All deliveries of goods, execution of work and rendering of services were to be strictly governed by contracts, for the due fulfilment of which the parties were legally responsible. Losses incurred by economic organisations were in no circumstances to be covered by the Gosbank. In the event of any organisation failing to meet its liabilities to the bank the latter might not only revoke its credit, but restrict or entirely block withdrawals from the defaulter's current account or, as a final resort, proceed to distrain on the enterprise's goods.

On 23rd July 1931 a decree was issued by the Council of Labour and Defence "concerning the turnover capital of State Combines, Trusts and other economic organisations". Prior to this decree it was sufficient if an enterprise's own capital and long-term indebtedness were covered by its fixed or gradually realisable assets. There was no legal provision for any definite amount of working capital. In the period of automatic credit, when all requirements for current expenditure were unconditionally met by the bank irrespective of the client's financial position, the possession of working capital was of no consequence. If an enterprise worked at a loss its deficit was made good by the bank, and even if it made profits there was no incentive to increase its working capital. Consequently many enterprises immobilised their own liquid funds,

often including short-term credit, in unnecessary capital investment or in accumulating excessive stocks of goods and material.

The decree laid down that an enterprise's own working capital must be employed exclusively "for maintaining minimum stocks of raw material, stores, fuel, partly manufactured and finished goods and for preparatory expenditure necessary to assure the next year's programme". The Gosbank might only grant short-term credit for such requirements as financing the transport of goods, seasonal manufacturing processes, seasonal accumulations of stocks of raw material, fuel and other consumption stores and manufactured goods. In order to provide individual enterprises with working capital, trusts and combines distributed a considerable proportion of their accumulated liquid funds among their constituent units. A further decree of 2nd December 1931 provided that trusts and combines must return to each of their enterprises a portion of that enterprise's own profits. On 13th October 1932 still another decree was issued laying down the principle that the first charge on planned profits after the statutory deductions have been made, is for supplementary working capital. Interim profits made by an enterprise in excess of its plan remain at the disposal of the enterprise "for strengthening its manœuvring capacity" during the current year. At the conclusion of the financial year 50 per cent of any surplus profits may be used by the enterprise for extending its production, for improving the living conditions of its employés, for paying individual premiums, etc. Budget grants are also made towards the working capital of industrial enterprises in proportion to the degree to which they have fulfilled their previous plan and

according to the results required of them during the succeeding period. Budgetary grants also depend on the fulfilment of the general financial Plan or, in other words, on budget funds being available. The inflationary creation of money for economic development was to cease.

During the first Five-Year Plan a large number of state enterprises made losses. That is to say, production costs were not reduced in harmony with the Plan, raw material was uneconomically consumed and estimates for wages, fuel and general overhead expenditure were exceeded. Prices of finished goods were fixed by the Plan according to the estimated or planned cost of production, and therefore the income of many enterprises was insufficient to cover expenditure. The resulting deficits at the time were apparently covered out of the liquid capital of the individual enterprise or the trust and by credit from the Gosbank. How much of the bank's credit thus became frozen has never been divulged, but there are grounds for believing that the hopelessly frozen assets were transferred to the Commissariat of Finance. In effect this means that industrial losses were covered by budget appropriations or, in fact, despite all decrees to the contrary, largely by an inflationary expansion of the currency circulation. Even in 1933 a number of important industrial units were reported to have made losses. For instance, the Cotton Trust of Orechovo-Zuyevo showed a loss of R.10 million, while the irrecoverable claims, or bad debts, of the Moscow Electric Works amounted to R.80 million. Particularly heavy losses were made by the Consumers' Co-operative Organisation. The Moscow Union of Consumers' Co-operatives showed a deficit of R.12 million, and of 98 Workers'

Co-operatives 68 showed deficits totalling nearly R.5 million.

The financial troubles of the state economy were no doubt due in part to over-optimistic planning and the incompetence or carelessness of industrial and commercial management. Another circumstance which no doubt encouraged uneconomic management was the starved state of the market. In consequence of the comparatively low fixed commodity-prices demand was far in excess of supply. While there was no competition in selling goods there was keen competition to obtain supplies of raw material and, though every state enterprise was supposed to be assured of its planned ration at fixed prices, supplies were frequently short. Manufacturing enterprises were often compelled to pay premiums to obtain material, which was illegal, or to restrict output, which brought them into trouble with the Commission of Soviet Control, whose functions include a sort of government auditorship.

As the result of various decrees and regulations issued between 1930 and 1934, all industrial and commercial enterprises should possess sufficient working capital to cover their own normal minimum current requirements, short-term credit being confined to financing seasonal fluctuations and goods in transit. The most important technical alteration in the system was in giving credit to the buyer instead of to the seller. At the same time the authority and initiative of the bank were greatly increased in order to enable it the better to fulfil its rôle as controlling agent under the Plan. It seems probable that these measures had a certain degree of success in economising bank credit and inculcating a greater sense of financial responsibility in business

management. During 1933 and 1934 the statements issued by the Gosbank and the Commissariat of Finance did not show any appreciable expansion of the currency circulation, while there was a tendency for open-market prices to fall.

CHAPTER III

ORGANISATION OF INDUSTRIAL ADMINISTRATION

DURING the first year or two of the Revolution the country's industry was left very much to itself, the new Soviet Government being preoccupied with other matters than industry. At the time of the actual Revolution the workers, putting into practice one of the basic Marxian axioms, seized factories and attempted to run them for their own benefit under workers' committees. The results were, not surprisingly, anything but encouraging. It is quite possible that the revolutionary leaders were not altogether sorry to see the industrial chaos produced, since it made the way easier to complete state control.

A Supreme Council of National Economy was one of the earlier departments of the new Soviet Government. Part of its task was to salve and reorganise what was left of the country's industries. The Council began by establishing a large number of committees, boards, etc., to take over the control and direction of all the various economic activities, and by the end of 1920 there were in existence 52 so-called Chief and Central Committees, 81 Regional Economic Councils, four District Industrial Bureaus and one Central Economic Council (in Turkestan). Generally speaking, there was a Chief or Central Committee for every distinct class of industry, but there were also territorial divisions, and territorial boundaries often cut across technical divisions. The biggest industrial units were directly

administered by the appropriate Central Committee, the less important enterprises came under Regional Councils and other subordinate organisations, but all major questions of policy were decided by the Supreme Council. Planning began to make an appearance in the shape of a Commission of Consumption, whose chief function was to take over and distribute all stocks of material and goods (mostly remains from pre-Revolutionary days). During this period a tentative attempt was made to do without money and to substitute a system of distribution in kind of consumption goods to the proletarian workers.

When in 1921 the New Economic Policy came into effect there was an immediate and strong reaction against the supercentralisation that had more or less inevitably accompanied War Communism. Since the Revolution one important and constructive development had been made. Most industrial enterprises had been associated into trusts. Strictly speaking, trusts were Government organisations, since practically all large-scale industry was owned by the State and the appointment of managers and directors was a function of the government. But apparently the trusts originally represented the interests of their constituent factories as well as passing on or executing the orders and decisions of the government departments. Under the New Economic Policy the rôle of the trusts became much more important, since under the new conditions market relations between economic units were revived. Among other things, the trusts began to do the commercial buying and selling for their constituents, and factory directorates devoted themselves almost exclusively to production and internal affairs. Naturally all these developments were sanctioned by the Government,

but for the moment the policy was to permit a very considerable revival of private initiative in the so-called non-socialised sector and a large measure of independence in state economic organisations. During this period a very considerable proportion of industrial output was provided by private enterprise, but no privately owned factory or workshop was included in a trust. As a matter of fact, though in the aggregate private enterprise was important, there were no individual big private enterprises, except the factories taken over by foreign concessionaires, and these, of course, were in a different category.

In 1922 the trusts in a number of the biggest industries formed associations, generally known as syndicates, principally to look after their commercial interests with the rest of the country. The syndicates undertook all the buying of raw material, etc., for their associated trusts and disposed of the finished products of the trusts' associated factories. Meanwhile the Chief and Central Committees of the Supreme Economic Council were disbanded and their functions were gradually more and more assumed by the syndicates, whose capital was provided partly by the trusts and partly from the liquidation of the Central Committees. Thus decentralisation progressed and the Government maintained through the Supreme Economic Council only a general supervision of industry and controlled its development mainly through its credit policy, for the Government always maintained a strict hold on its monopoly of finance.

Between 1921 and 1926 the national economy was permitted to develop almost spontaneously and freely, but in 1926 the idea of planning began to take concrete form. The Supreme Economic Council was reorganised

and departments or committees (generally known as Central Administrations) were established for each separate industry. These were responsible for the plans of their respective industries, but over enterprises of national significance the Chief Administrations, in addition to mere planning, exercised a certain supervision. Planning for enterprises of local significance was relayed from the Supreme Economic Council through the Republican Councils, so that the plans drawn up by Chief Administrations embraced all the enterprises belonging to each industry throughout the whole Union. In order to correlate and combine all the separate industrial plans in one comprehensive whole a central planning section of the Supreme Economic Council, called the Planning-Economic Bureau, was formed, whose duty was to combine the results of the Chief Administrations' work, check the annual plan of production and capital extension of each industry and finally amalgamate the various individual plans into a single national plan. As a result of this reorganisation, the part played by the Supreme Council in controlling industry was greatly enhanced. During the two or three years prior to the first Five-Year Plan the interference of the Government in the open market increased with the growing trend towards price-fixing, control of the purchase of agricultural produce and regulation of the distribution of industrial manufactures, credit operations, etc. Gradually the economic freedom enjoyed by industrial enterprises during the N.E.P. period was curtailed, giving place to a complete system of planning and rationing.

By the end of the first year of the first Five-Year Plan (September 1929), the free commodity market had practically been destroyed. At the 16th Conference

of the Communist Party in May 1929 it was resolved that "the realisation of the task of speeding up the tempo of industrialisation demands the systematic revision of the whole Government administrative apparatus to bring it into conformity with our economic system and the problems of socialistic construction . . . to secure the transformation of the Supreme Economic Council into an organ not only of economic planning as heretofore, but into an instrument of active technical direction . . . to strengthen the economic initiative of factories, works and individual workshops by simultaneously enlarging the rôle of the trusts in the management of the technical reconstruction of enterprises".

At the end of 1929 the Government issued a decree for the reorganisation of industrial administration. In course of time the syndicates, originally established to look after the commercial interests of industry, had taken into their hands a large measure of the actual management or control of their industrial enterprises. Most syndicates had been compelled to occupy themselves with questions of production programmes, capital construction, general planning, supplies, disposal of output, etc., so that in practice they were doubling their own proper functions with the work of the Chief Administrations. It was decided, therefore, to liquidate the latter and transform the syndicates into combines whose functions were to include production planning, planning and control of capital construction, technical management, organisation of supplies and disposal of output, labour questions, and the appointment and dismissal of the managerial personnel. Three types or classes of combines were recognised:

- (1) Combines embracing only enterprises and trusts

of union importance. These were to exercise control over all activities of their subordinate enterprises on the lines mentioned above.

(2) Combines embracing enterprises and trusts of both union and local significance. With respect to enterprises of union significance their functions and duties were similar to those of combines in the first category. But with respect to enterprises of republican significance the combines were to fulfil the functions of the old syndicates in addition to planning production and capital construction, general technical control in the provinces of rationalisation and reconstruction and in the provision of skilled labour cadres.

(3) Combines embracing only enterprises and trusts of republican and local significance. These were to carry out the functions of syndicates, to which were added general inter-republican planning of production and capital construction and supervision of rationalisation processes, especially with regard to technical construction.

The most important part of the work of combines generally was the direction and control of the technical productive work of their subordinate enterprises.

Trusts, as explained before, were associations of a number of individual enterprises belonging to the same industry. In some cases the trust formed a link between the combine and the individual enterprise, in others combine and enterprise were in direct contact. The trusts were to confine their activities to matters connected with the technical supervision of reconstruction together with the duties of buying and selling agencies for their associated enterprises.

The Supreme Economic Council was in future to devote itself to working out production and finance

plans of industrial development and technical reconstruction, to correlating the activities of the different branches of industry, to the elaboration of the general direction or framework of current planning and the regulation of industry, to controlling the fulfilment of the plan and to founding and organising economic organs and their terms of reference. The Supreme Council was also charged with the duty of appointing and dismissing the managements of combines, approving their accounts and balance-sheets, deciding on the distribution of their profits and losses, approving the expenditure of special capital funds, determining their statutes and foundation capital, and generally to supervise all their activities and fix the prices of their products.

The scheme of industrial administration was, therefore:

The Presidium of the Supreme Economic Council
of the U.S.S.R.

The Technical and Economic Planning Section or
Committee of the Supreme Council

The three classes of Combines:
Trusts, individual factories, works, etc.

The whole system was based on specialisation and centralisation. As regards specialisation, for instance, all buying and selling, constructional and even installation work was taken away from the trusts and put under particular specialised organisations, the trusts being reduced to the rôle of mere technical supervisors. Centralisation resulted in combines having an enormous number of individual enterprises (sometimes as many

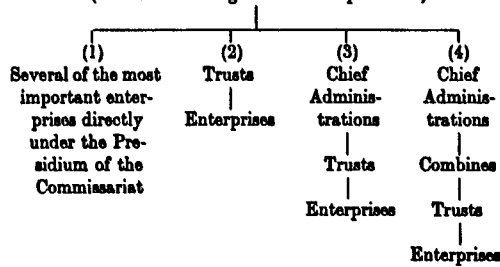
as 200) subordinated to them. In such circumstances detailed attention could not be given to all the problems arising, and planning often became a matter of mere paper programmes divorced from reality. As a result, financial discipline became slack, production costs rose and the collegia (or managing boards) of the combines issued reams of paper reports and instructions without achieving any visible improvement. Stalin decided on another reorganisation, the principal feature of which was the splitting-up and reduction in the size of the unwieldy combines. By a decree of 1931 the combines were split up and specialised and their numbers and the numbers of trusts were increased. In heavy industry by October 1932 the number of combines had been increased from 32 to 78 and the number of trusts from 13 to 152. In November 1932 another decree transformed or reduced many of the combines to the status of trusts, which, however, again began to assume a more important part in the industrial scheme. At the same time the Chief Administrations, abolished in 1929, were revived for certain industries, their functions being limited to planning and co-ordination between different industries. Technical or operative control of industry was placed under so-called "functional sectors" established by the Supreme Council for dealing with the various problems connected with the various industrial processes and activities.

In 1932 the Supreme Economic Council was converted into, or substituted by, the People's Commissariats of Heavy, Light and Timber Industries, which, with the Commissariat of Food Industries, formed the four Government Departments, Commissariats or Ministries which, between them, controlled the whole of the country's industrial economy.

At this time a rapid succession of decrees was issued with the common object of giving individual enterprises greater control of their own working capital, the disposal of part of their own profits and of strengthening the authority and position of their own managements. This was accompanied by a disinclination of works' managers to accept increased responsibility because of their incapacity or unwillingness to master technical or economic problems. This gave rise to a division of authority and responsibility; in some of the larger coal mines, for instance, there were, besides the general manager, more or less independent managers for mechanisation, ventilation, safety measures, etc. This led to the Government taking measures to insist on the single and individual responsibility of heads of enterprises, to secure that they were qualified for the posts to which they were appointed, to reduce the number of independent departments and divisions in factory administrations, to reduce the personnel of administrative staffs, etc. (Within the twelve months December 1932 to December 1933 the administrative officials and staffs in heavy industry enterprises were cut down by nearly 120,000 persons.) The industrial troubles being partly due to the poor quality of the younger engineers who were drafted into factories after very short and intensive periods of training, the courses in future were to be extended, more thorough and comprehensive, while entrance to the higher technical schools was to be by examination. At the same time there was further specialisation and subdivision in the Chief Administrations of heavy industry and in their subordinate trusts.

As a result of all these various changes and reforms the organisation of heavy industry came to present the following picture:

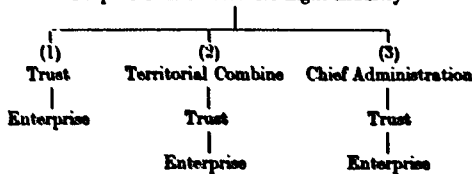
The People's Commissariat for Heavy Industry
(with status of a government department)



System No. 4 was applied to the smallest or most dispersed enterprises; thus the more important an enterprise was the nearer it stood to the Commissariat, while the less important enterprises stood at the end of a line of intermediate organisations. Republican and local industries came indirectly under the People's Commissariat through the medium of the corresponding Republican, Provincial or Regional Commissariats.

The organisation of light industry was on similar lines, the most important difference being that there were no individual enterprises directly under the People's Commissariat. The various systems were:

People's Commissariat for Light Industry



Since the above organisational schemes were decreed there were, up to the end of 1935, no fundamental changes in the system, but certain amendments and elaborations were made as experience indicated the necessity. In March 1934 a government decree was issued prescribing more direct, and eliminating delegated, authority and responsibility in all branches of Soviet economic activities, improving the liaison between the highest and the lowest links in the administrative organisation, eradicating bureaucratic methods of management and extending the principle of single direction and personal responsibility in managing personnel. The decree also provided for the abolition of the system under which each manufacturing and technical process came under a specialised department, giving rise to several independent authorities in the same factory. The Chief Administrations of the People's Commissariats were reorganised and subdivided into separate departments for different industrial products, while interference by higher authorities into the routine work of enterprises was restricted. Republican, provincial and local authorities were given greater power and discretion in directing the policy and development of local industry, which was removed from the immediate control of the central Government.

Other provisions of the decree made for a reduction in the number of intermediate controlling organisations and made the heads of all economic organisations personally responsible for supervising and checking the work of enterprises immediately under them instead of delegating investigations to subordinates. The system of collective or collegiate management was abolished and authority and responsibility as a rule vested in a single head with two assistants. Gener-

ally speaking, all these measures had as their aim to allow greater initiative, authority and responsibility to factory managers and others in their own particular sphere and to secure that these were technically and by experience qualified for their posts; and to reduce the top-heavy and unwieldy higher and non-reproductive organisations which had proved only hindrances to progress and development, leaving to the government departments and remaining intermediate organisations little more than the task of planning, directing and co-ordinating the general policy.

In the second half of 1934 the organisation of Light Industry was further elaborated. The Commissariat was reorganised to include fourteen Chief Administrations (*e.g.* one each for the cotton textile industry in the Moscow and Leningrad districts and two for the Ivanovo district, one for the whole woollen textile industry and so on). Each Chief Administration included an economic accounting office for supervising technical supplies (raw material, etc.) and another for supervising the disposal of the industry's finished output. The Government also formed 12 economic departments, sectors or groups for economic planning, trade, statistics, accounting, exports and imports, etc.; these apparently exercised research and advisory functions only. They were incapable of giving orders or instructions direct to any organisation, but might make recommendations to the Commissariat, which was responsible for putting them into effect.

The whole history of economic development since the Revolution consists of a series of compromises between practical needs and Marxian-Lenin theory. The first stage, for practical purposes, was the so-called N.E.P. period. The two years of War Communism were too

short and too chaotic to prove anything, except that an abrupt transition from capitalism to full-blown communism is just as impossible and fantastic as the emergence of a butterfly from the egg without the caterpillar and chrysalis stages.

Under N.E.P. industry revived and was developing rapidly on more or less proved capitalist lines, because the managers and directors of economic enterprises enjoyed a large degree of freedom and initiative, markets were free and prices were automatically adjusted by the normal interplay of supply and demand. With the revocation of N.E.P. and the introduction of planning there was an end of free markets and the influence automatically exerted through prices on the efficiency and conduct of industrial enterprises. In its efforts to force the pace of industrial development the Government created an enormous centralised administrative mechanism. This seems to have been divided, broadly, into two parts, viz. planning and all that that implies, such as distribution of goods and material, labour and finance, and general co-ordination to secure an harmonious development of all branches of industry and the best use and most rapid turnover of material and labour; secondly, a technical side concerned with standardising and improving manufacturing and scientific processes, distribution of technical information, etc. At the beginning of the planning era centralisation seems to have reached an exaggerated pitch. The government departments, first the Supreme Economic Council and afterwards the various Industrial Commissariats, assumed directly or through the syndicates and combines a most detailed control of all enterprises, leaving in fact little initiative of any kind to the men on the spot. Technical centralisation seems to have

gone extraordinarily far, for boards or committees appear to have been set up to provide expert supervision, if not control, of specific processes. This was the so-called "functional system". As an example, all the chemical laboratories in all textile factories came under the supervision or control of some sort of central chemical institute for textile industries. The supply of material and disposal of finished goods was also highly centralised. All this led to a terribly complicated division of duties and responsibilities. Probably to a large extent the system was forced on the Government by the lack of experienced and qualified personnel to manage all the factories and works in the rapidly expanding industries. Certainly because of, or perhaps in spite of, this system, industrial production rapidly increased, especially at first. But in all other respects efficiency standards fell, costs increased, quality deteriorated and assortments or descriptions of manufactured goods became stereotyped and increasingly at variance with the requirements of the consumers. Market demand had, of course, long since ceased to have any influence on industrial output.

The first Five-Year Plan began on 1st October 1928, and it is rather significant that the years 1931 and 1932 saw tremendous changes and modifications in nearly the whole of the economic field. The whole financial and banking system was overhauled and in industry there was a great reaction from the original policy of intensive centralisation. The general tendency was towards a splitting-up and greater specialisation of the existing superior organisations, and at the same time their direct interference in the routine work of the actually productive enterprises was drastically restricted. Responsibility for results was shifted lower down. The

trusts, after suffering a period of more or less eclipse, again became of primary importance. In a sense they may be said to have become the pivot between the productive enterprises and the government economic departments, which much less than before now meddled with details. The trusts became responsible for the technical efficiency of their subordinate factories; they organised through special commercial departments all the buying of raw material and selling of the finished goods for their group of enterprises and generally looked after their interests and finances. The administrative system, as broadly applied to industry as a whole, was, at the end of 1934, somewhat as follows:

(1) The four People's Commissariats, viz. for heavy industry, 'light industry, timber industry and food industries, were responsible for the policy and plans of their branch of industry within the general framework of the whole national industrial plan.

(2) The Central Administrations, which may be regarded as departments of the Commissariats, each dealt with a specific class of industry, *e.g.* textiles, coal mining, leather, pottery, glass, etc. In some of the biggest key industries such as textiles and coal mining several Central Administrations were established to which were allotted the enterprises in a definite territory. The work of Central Administrations was largely concerned with planning in much greater detail than the Commissariat. They were also made more or less responsible for the scientific research institutions connected with their industries and for distributing the results of the institutes' investigations. They exercised a general supervision over their subordinate organisations, such as the trusts, but not to the extent of interfering in the details of factory administration.

(3) Combines were not an essential part of the organisation of industry. The Russian word "Obyedinenie" literally signifies a unification in the abstract. In the concrete sense it means a society or association. An industrial combine may be an association of enterprises or organisations which have combined for any common purpose. Generally by combine is understood an association of trusts which, for some reason, usually because of their individual insignificance, it is more convenient to place collectively under the Central Administration. Trusts forming members of a combine were less complex and had less powers and initiative than those directly responsible to a Central Administration. The functions of a combine were, broadly, the same as those of a big trust (*q.v.*).

(4) Trusts.—Nearly all industrial enterprises belong to a trust. The exceptions are the very biggest heavy industry units, such as the biggest motor, tractor and machinery factories and the gigantic metallurgical works which are directly responsible to the People's Commissariat, and a few somewhat smaller enterprises which are directly responsible to their relative Central Administration.

The trust became the industrial administrative unit with full authority and control over its constituent enterprises, both in financial and technical questions. It was made responsible for supplying its factories with raw material and all necessary consumption goods and for disposing of their finished output. It was also made responsible for seeing that its factories were technically up to date and that the technical and administrative management was efficient. Within the framework of the Plan the trust had a considerable measure of autonomy in matters affecting the internal economy of

its group. The latest tendency is to increase the authority and functions of trusts (in some consumption industries trusts run retail shops for the sale of their manufactures) and to reduce the number of enterprises in the group. As a general rule the organisation of trusts and combines is on a horizontal basis. The idea of vertical organisations does not seem to have found much favour.

PART II

CHAPTER IV

SOVIET CURRENCY

SOVIET currency is composed of the following :

- (1) Bank-notes in denominations of 1, 2, 3, 5, 10, 25 and 50 chervonets (1 chervonets = 10 roubles); these are obligations of the State Bank of the U.S.S.R., generally known as the Gosbank, and their total circulation on 1st July 1935 was 4407 million roubles.
- (2) Treasury notes in denominations of 1, 3, 5 roubles; these are obligations of the Treasury, but are issued by the Gosbank. Their total circulation on 1st April 1935 was 3501 million roubles.
- (3) Silver coins of one rouble, 50, 20, 15 and 10 kopeks, and copper coins of 5, 3, 2 and 1 kopeks.

Legally the circulation of bank-notes must be covered to the extent of at least 25 per cent by gold, foreign exchange and other precious metals, and for the remainder by short-term internal obligations; the gold must be valued according to the theoretical gold-content of the rouble (1 gram of fine gold = 1.29 roubles), and foreign exchange at a rate based on this content and the current price of gold. According to the return of the Issue Department of the Bank of 1st July 1935, the firm cover was 21.5 per cent of note circulation.

The value of Treasury notes in circulation must not exceed that of the bank-notes. No details of their cover are published, but the position appears to be as follows: in addition to the chervonetz notes in circulation shown in the bank return, a further amount equal in value to the Treasury notes in circulation is deposited with the Treasury as cover for the Treasury-note issue.¹ This system is a relic of the early years 1922-24, when there were two separate and unrelated currencies in circulation, the new firm chervonetz and the depreciated Soviet paper rouble. The arrangement would seem to serve little useful purpose, for the two sorts of notes in reality constitute (1935) one issue of about 8 milliard roubles with a firm cover of about 12 per cent. Rouble notes are needed as a supplementary fractional currency, the chervonetz being an inconveniently large unit; but the fact that they are nominally obligations of the Treasury, and not of the bank, is of no significance, since both issues are accepted indifferently, and are inconvertible.

In the period 1920-22 uncovered rouble notes were printed in immense quantities by the Treasury to cover budgetary deficits. Inevitably the paper rouble soon became worthless and a new currency had to be introduced. On the 11th October 1922 a decree was issued granting the newly formed State Bank the right of issuing bank-notes. Though nominally a gold currency, the new notes were not convertible into gold,

¹ According to the *U.S.S.R. Handbook 1936* (p. 327), the People's Commissariat for Finance hands over to the State Bank a special reserve fund, which is safeguarded in strong rooms at the bank and is at the exclusive disposal of the Commissariat. This reserve fund is believed to consist, in part at least, of the Imperial Russian crown jewels, which important foreign visitors to the Soviet Government are sometimes allowed to see. It is also possible that the fund contains gold bullion or coin.

but it was intended to make them so, at some future time. Meanwhile the old rouble notes continued to circulate alongside the chervonets until they were finally redeemed in 1924 at the rate of 50 milliard paper roubles for one gold rouble. As it was impossible to increase the chervonets issue in view of the legal metallic cover and because a divisional currency was necessary, an issue of new Treasury notes in denominations of 1, 3 and 5 roubles was made with which the old rouble notes were redeemed. The issue of these rouble notes was at first limited to 50 per cent of the circulation of bank-notes.

The volume of the total currency issue is officially described as being fixed by the Plan in accordance with the need for currency to carry on the business of the country. Notes and coin are only used for wage payments, purchases of grain, etc., from the peasants, transactions between government institutions which are too small for clearing, and in retail trade. During the first Five-Year Plan the circulation expanded much in excess of the original planned figures, partly to cover unforeseen industrial losses and partly to cover the industrial wages bill which showed an unplanned increase. Since the output of consumption goods did not increase in proportion and since prices were arbitrarily fixed at a comparatively low level, the increased effective demand of the population for consumption goods could not be satisfied and consumption had to be restricted by rationing. During the last quarter of 1933 and 1934 the volume of currency in circulation remained fairly steady at a figure of about R.6500 million for both bank and Treasury notes together. In 1935, however, the circulation again rose sharply, mainly due to the effect of derationing, which involved a substantial

rise in price-levels, while, as a partial compensation for the resulting rise in the cost of living, wages were increased on an average by about 10 per cent, and the prices paid by the State for the peasants' produce were also increased.

In calculating the amount of currency in circulation, account is taken only of notes actually in circulation and the notes held in the branch banks to cover day-to-day requirements. Reserves of notes held locally in provincial head offices of the bank against eventual requirements are considered as withdrawn from circulation. Owing to the great distances in the U.S.S.R. it would be impracticable to depend on the Moscow Issue Office for fresh supplies of currency to meet more or less unexpected demands.

CHAPTER V

THE THEORY OF FINANCIAL PLANNING

THE fundamental difference between the Soviet and capitalist financial and monetary systems is in the Soviet planning. Technically the execution of the Plan shows no very radical divergences from capitalist practice; the methods of accounting, bank administration, etc., have in some respects been simplified and adapted to Soviet peculiarities, but certainly contain no startling innovations.

The Financial Plan may be divided into three aspects: the General or Unified Finance Plan, the Credit Plan and the Cash Plan which includes the currency circulation. The Unified Finance Plan is, to all intents and purposes, a comprehensive budget for all state activities involving the receipt or expenditure of money. The official budget accounts only for money directly passing through the hands of the Finance Commissariat, while the Unified Plan concerns itself with the total receipts and payments of all state enterprises as well as the finances of commerce and non-economic institutions. The most important section of the Plan is that relating to state industry. The Financial Plan has its counterpart in a Material Plan, which determines the production and consumption of raw material and manufactured goods, the progress of new construction, the reconstruction of existing factories, works, plants, etc. Obviously, the two plans must agree; they are, in effect, two versions

of the same plan and each serves as a check on the other. For instance, new capital construction must be limited to the amounts of money, *i.e.* national savings, available; while the material out-turn of a manufacturing enterprise determines the amount of working capital required for raw material, wages, etc. Consumption of goods and raw material in new construction and in producing manufactured goods is naturally limited to the amount of goods and material produced or available. The Material Plan provides for the distribution of raw material in stages; firstly in bulk to each class of industry, then split up and divided by the relative government department among the various combines and trusts which finally make the detailed allotments to individual factories and works. No doubt both trusts and individual enterprises are sometimes tempted to indent for more material and labour than is economically necessary, especially since experience has shown that the full planned supplies are often not forthcoming. It depends on the efficiency of the planning sections of the government departments, combines and trusts to see that the planned distribution is in accordance with the capacity of, and the output required from, each unit. Once the Material Plan has been fixed, the Credit Plan comes into play to see that it is properly carried out.

So far as long-term credit for capital construction is concerned, the task of controlling expenditure is relatively simple. Cost estimates having been prepared, the Long-Term Credit Bank has to do little more than issue funds as the work progresses and keep a current check or audit on prices, wage sheets, etc., to see that actual costs are not exceeding the estimates. The bank has no discretion to pay out to any client more money

than is authorised by the Plan for the current period, and if estimates are exceeded, whether or not as a result of the fault of the client, a supplementary grant or loan can be authorised only by the Government.

Short-term credit planning is a more complicated matter. The Credit Plan is naturally closely linked with and is based on the Productive-Finance plans of the various branches of economic activity. The total amount of short-term credit in any quarter must correspond with the aggregate requirements of industry and trade for liquid cash over and above their own working capital, and this in turn depends on the plans for industrial production, trade turnover and collections or purchases of grain and other produce. The average credit term must similarly correspond to the average period of commodity turnover. The general Credit Plan is thus drawn up to agree with the general Production Plan, and, like it, it is distributed step by step until the details for each individual enterprise are fixed.

Before the general Credit Plan can be drawn up it is clearly necessary to determine the prospective credit needs of the individual enterprises to whom credit is to be granted. Each enterprise, therefore, draws up its own finance plan, including an estimate of the amount of credit it will require to enable it to fulfil its material plan. This draft or preliminary plan is submitted to the bank, which analyses it as follows:

- (1) By checking the value of stocks of material, finished goods, etc., necessary to realise the production plan, to be acquired in excess of the enterprise's own working capital.
- (2) By comparing stocks of material, etc., on hand

with the planned balance remaining at the close of the period, to determine what proportion of existing stocks will be consumed and whether the planned consumption in the manufacturing processes corresponds with the norm as laid down by the planning authority.

- (3) By noting whether the proposed purchases of goods and material for a given output bear a normal relation to the planned consumption and output of other enterprises of the same type.

By checking these three factors the bank can determine whether the minimum requirements of the enterprise during the coming quarter warrant credit being granted.

- (4) By examining the enterprise's bank account to see whether it discloses any non-planned commercial credit, that is, credit given to or received from other industrial or trading organisations.
- (5) By examining other features of the enterprise's planned activities to see whether the maximum mobilisation of its own resources has been carried out. That is to say, whether the enterprise possesses any assets, such as plant, buildings, material, etc., which, being unnecessary to its proper activities, should be converted into liquid cash.

In this way the bank is able to prevent any excessive demands for credit. In fact it carries out something in the nature of an audit, which gives, at any rate, some indication whether the enterprise in question is working at a loss or profit and whether it is indenting for credit to cover losses or for financing genuine requirements. The bank's investigation does not determine

the final allotment of credit; it merely serves as a guide to the aggregate volume of credit to be granted to the industry as a whole. The final and decisive allotment of credit to the individual enterprise is a matter for the relative trust alone, but as the trust cannot allot more than its own quota it can unduly increase the share of one enterprise only by starving another.

If short-term credit were granted without reference to the volume of deposits lying to the credit of economic organisations in current and accounting accounts at the Gosbank, the total potential purchasing power might be dangerously inflated and it is possible that, despite all checks on currency circulation, the note issue might also expand undesirably. The Government, therefore, when passing the departmental finance plans, keeps in view the relation between the receipt and issue of funds under the general Credit Plan, particularly with regard to the unemployed free balances of all economic institutions. While the volume of short-term credit actually granted depends, not so much on the actual short-term resources at the bank's disposal, as on the actual requirements of the Material Plan, precautions are taken to guard against an inflationary increase in the net indebtedness of the national economy to the Gosbank, which would be reflected to some degree at least by an expanding circulation.

The planning of currency circulation is inseparably linked with credit planning. In 1930 that planning was extended to cover the paying in and receipt of currency over the bank's counters by all branches of national economy. This was made possible by the introduction of the Unified Financial Plan, which includes estimates of all currency to be withdrawn from

circulation through taxation, loans, savings deposits, subscriptions to co-operatives, etc.

Currency mainly goes into circulation by way of wage and salary payments and payment to peasants for their crops, and is withdrawn from circulation by way of taxation, retail trade and savings deposits. Every district has its own finance plan involving the collection of a planned amount in taxation, increases in savings deposits, etc. So-called "socialist competitions" are arranged between districts to fulfil or exceed their finance plans, and considerable prominence is given to the results in the press. If the plan is not fulfilled it means that so much more currency remains in circulation and that the State's funds for economic development are short by the same amount. Prior to the credit reform this was not considered a serious matter and the difference was made up by the issue of more currency. This, in fact, was a factor in the inflationary increase in the circulation prior to 1931. Since then it has been realised that the correct fulfilment of the cash plan is an important condition of successful planning as a whole.

All state, communal and co-operative organisations draw up quarterly cash plans as well as comprehensive finance plans. These cash plans are handed to the Gosbank and the communal banks, who co-ordinate them with the estimates for the mobilisation of the resources of the population by means of taxation, subscriptions and contributions and the sale of goods. Thus, each branch of the Gosbank and Communal Bank is able, on the basis of the cash plans of its clients, including, of course, deposits of tax receipts, etc., by the fiscal authorities, to calculate approximately its own cash position for the coming quarter. The aggregate net

result of the individual banks' cash plans should correspond with the general plan for the whole of the national socialised economy (i.e. state, communal, co-operative and collective institutions and enterprises) and determines whether the currency circulation can be contracted or will need to be increased during the coming quarter.

The due fulfilment of the Gosbank's credit and cash plans depends on the due fulfilment of the material plans of industry, trade and agriculture. Any failure in the fulfilment of an enterprise's finance plan must be due to some breach in its material plan and will be reflected very soon, if not at once, in its credit or cash plan. The bank is consequently warned that something is wrong. For instance, when making application for credit a client must give documentary proof that his own liquid funds have been fully employed and attach a list of the goods or material in stock at the moment. If the value of these is materially different from the planned turnover fund, it means that (a) losses have been incurred, (b) that goods have been sold on credit or (c) that liquid assets have become at least temporarily immobilised; this may merely mean that the period of manufacture of finished goods has been longer than planned or that, through lack of transport or other causes, finished goods have not been realised as rapidly as they should have been. Failure to repay advances at maturity gives the same warning.

The control works in two directions: on the one hand, the responsible management of an enterprise is stimulated to maintain efficiency through the knowledge that any lackness or extravagance cannot be hidden for long; on the other hand, any breach of the plan is soon made apparent to the bank, which, after satisfying

itself as to cause and responsibility, should take steps to have the fault remedied. In extreme cases the bank can go to the length of distraining on a debtor's goods. It seems likely that this system of control is responsible for the not infrequently reported cases of infraction of price regulations. Failure to secure supplies of raw material or goods is not accepted as a good excuse for failing to deliver the planned output, and payment of a premium to get the required material or goods may be practically forced on the manager of a factory. He will naturally try to cover the cost by charging higher prices for his finished goods.

In paying out currency for wage payments the bank limits the amount to the clients' plan, and no increase in this limit is admissible unless there is shown to be a corresponding increase in the enterprise's output. In no case can an increase over the planned amount for salaries of administrative employes be granted. In paying out money for wages and salaries the bank has to take into account the amount of deductions on account of taxes, subscriptions to state loans, direct payments into the employes' savings-bank account, etc. This control by the bank of wage payments plays an important part in regulating constructional costs, of which, on the average, 30 to 40 per cent are on account of labour.

The use of cheques by organisations in purchasing goods on the retail market is strictly prohibited. This enables the bank to limit withdrawals of cash for this purpose to the amount of the organisation's authorised "goods fund", and thus prevent the improper abstraction of consumption goods from supplies available to the general public.

From the foregoing it would appear that economic

organisations are under constant supervision regarding the use they make of their funds. Officially it is stated that the bank does not control an enterprise's use of its own money "so long as it is employed for legitimate purposes", but if the bank, as theoretically it should, uses its authority to enforce this principle it is clear that its control is fairly substantial. The financial disorder that arose in the interval between the introduction of the first Five-Year Plan and the credit reforms of 1930 and 1931 clearly proved the necessity of a system of fairly rigorous control, but it may be questioned whether the system that has been evolved is not too rigid. Cases are not infrequently quoted in the Soviet press in which the alleged bureaucratic and uncompromising standpoint of local branch banks in dealing with emergencies has inflicted hardships on perfectly well-managed enterprises. The same circumstances also tend to discourage overfulfilment of the Plan. It is said, possibly with some foundation of truth, that enterprises having, through good management and efficiency, accumulated more free money resources than was planned, have used the surplus for purchasing unnecessary furniture, etc., as a kind of hidden reserve. On the other hand, there seems no doubt that "control by the rouble" has resulted in a reduction of waste and extravagance, in a better distribution of goods and in speeding up production and turnover. It has not had any spectacular success in lowering production costs nor in improving the quality of goods, and it has certainly not been accompanied by any reduction in the cost of living.

CHAPTER VI

CREDIT THEORY AND PRACTICE

§ 1. THE PRINCIPLES OF CREDIT PLANNING

THE annual Credit Plan is little more than a rough estimate of requirements for the twelve months concerned. The quarterly plans, which furnish the really operative dispositions, are drawn up by the Gosbank's planning department in close collaboration with the bank's branches and the industrial, commercial and other clients of the bank. The planning department at the head office of the Gosbank in Moscow is divided into sections for all branches of national economy and every regional head office and every branch has a planning section which, in the case of the smallest branches, may consist only of a single official known as a plan inspector. Planning starts by every client of the bank drawing up in the form of a budget of expenditure and receipts a plan for the succeeding quarter showing anticipated receipts and expenditure and the amount of credit considered necessary to finance the quarter's operations. Enterprises of purely local importance submit their budgets to the branch bank at which they keep their accounts, but enterprises which come under a trust submit their budget plans to this central organisation. These plans are then handed to the branch bank to which the trust is connected. On the basis of the information at their disposal concerning the financial plans of their clients every branch

bank draws up a plan of its own which consists of two statements showing:

- (1) against the name of every client the estimated state of its balance at the beginning of the quarter, anticipated movements during the quarter and the balance at the end of the quarter; and
- (2) the estimated resources at the disposal of the branch at the beginning and end of the quarter from its clients' deposits, including not only economic organisations but the current accounts of government institutions, financial authorities, trades unions, collective farms, other banks, etc.

These plans are then submitted to the regional head offices, which, in the same way as the trusts, co-ordinate them and pass them on to the head office in Moscow. In due course the various sections of the Commissariats for Industry, Trade, etc., receive from their subordinate organisations general financial plans in which are included the estimated credit requirements for the coming quarter. Similarly the head office of the Gosbank receives parallel documents from its branches. These general plans are in due course adjusted and agreed between the bank itself and the Government. From the returns received from its clients every branch bank calculates whether it will have to apply for additional resources to cover its clients' credit requirements or whether the funds at its disposal will be sufficient or even afford a surplus. Similarly the head office of the Gosbank draws up a general comprehensive plan under the following heads:

<i>Resources: Incomings</i>	<i>Distribution: Outgoings</i>
1. Own profits.	1. Seasonal needs of industry, transport, trade and agriculture.
2. Current accounts, including state and local budgets, insurance funds, savings-bank deposits, etc.	2. Advances against goods in transit.
3. Clearing accounts of industry, etc.	3. Contributions: (a) State's share of own profits.
4. Repayment of outstanding loans.	(b) Transfers to funds for employés' benefits.
5. Deposits of other credit institutions.	
6. Sundries.	

The balance of this statement shows whether the bank will be called upon to increase or be able to decrease its total credit to the national economy during the quarter.

As soon as the Finance Plan has received government approval the bank proceeds to distribute credit allotments in lump sums to the various Commissariats. These in turn divide their quotas among their subordinate trusts and combines, and these, in turn, further distribute their quotas among their individual enterprises. This last division is very detailed, the total being divided into quotas for specific objects such as purchase of raw material, fuel, etc. Eventually every regional head office and branch bank will receive a so-called "letter of limits", which, in effect, is a statement giving full details and maximum limits of the credit to be granted to each individual client. Since it is impossible to determine absolutely and precisely when and how much credit will be required by every single organisation, the credit limit fixes the maximum which can be drawn by the individual client, and this cannot be exceeded except by special permission from

some higher authority, but every higher organisation, trust and combine has the right to retain from distribution a certain proportion of its credit quota as a reserve for meeting emergencies.]

§ 2. INDUSTRIAL CREDITS

(Credit is given under three heads: planned, unplanned and advances against goods in transit.

Planned credit, as its name implies, covers credit requirements which can be foreseen and consists mainly of advances to cover seasonal fluctuations in the clients' purchases of raw material, manufacturing processes, etc.

The term unplanned credit really amounts to an admission that plans cannot be rigidly adhered to. In effect, unplanned credits are granted to cover temporary difficulties of a client, such as, for example, the non-receipt of payment at the due time for goods sold, having to hold goods for a longer time than was anticipated through inability to obtain transport, etc.] To a certain extent the branch banks themselves are allowed discretion in according unplanned credits, which are usually only for a few days, and in no case can be for more than a month. Each branch bank maintains a certain reserve in order to cover such emergencies. An application for an unplanned credit, which is not obviously due to a merely temporary cause has to be approved by the regional head office or, in extreme cases, by the head office of the bank in Moscow.

(Credit for goods in transit is an advance to cover the value of goods between delivery to the transport organisation, railway or shipping company and receipt of

payment from the customer) In view of the long distances that goods have to be transported in Russia, the lapse of time between despatch and receipt of goods is often considerable, and it is one of the main principles of the credit system that no enterprise shall ever in any way give credit to another enterprise. Therefore, immediately goods are despatched an advance is received from the bank to cover the period of transit or until payment is received from the buyer. (These credits cannot be exactly planned from day to day, since loadings are liable to fluctuate. Therefore a certain amount of latitude is allowed in budgeting for this type of credit. But in principle these credits are included in the general Plan, fluctuations being covered by reserves held at the branch banks for this specific purpose.

Credit limits may specify:

- (1) The maximum to which the client may be in debt to his bank at the end of the quarter, or
- (2) The amount by which the total outstanding credit at the beginning of the quarter may be increased (or must be decreased) by the end of the quarter.
- (3) The amount of credit which may be taken during the quarter irrespective of previous loans and repayments.

As a general rule, but by no means universally, the system adopted is that of determining the total outstanding credit. Obviously in times of heavy seasonal demands the maximum will be increased and at other periods it will correspondingly be decreased.

As remarked above, the credit limit represents the maximum to which the client can be indebted to the bank, but there is no question of his being entitled to

draw on this account as and when he will. In the first place, the total amount is subdivided into quotas for specific objects, such as purchases of raw material or finished goods, fuel, etc., and the bank will only issue credit for the specific authorised purpose in amounts actually required to pay for goods or services either ordered or more usually actually delivered. The bank is also charged with the duty of seeing that the objects for which credit is required are properly within the borrower's plan and that they are of such a seasonal or extraordinary character as to qualify them for credit.

(Every bank keeps as many credit accounts for each customer as there are objects for which credit has been allotted.) Thus, there will be a credit account for, say, fuel, finished goods, raw material, etc. If any one of these accounts is temporarily insufficient to meet extraordinary demands it is possible to transfer unused credit from another account. The same applies to the enterprise's own working capital, which is also allotted in quotas to specific purposes. In the event of credit allotted for one purpose being in excess of actual requirements, it is possible to transfer the surplus to another object for which credit has proved insufficient, but only with the express approval and sanction of the bank.

(Interest on all forms of credit is usually at the rate of 6 per cent per annum, and the average term of planned loans is four to five months.)

One of the main principles in the short-term credit system is that advances are given for a specific purpose and are repaid as soon as their purpose is accomplished. An example of financing highly seasonal production is afforded by sugar factories. Enterprises of this nature obviously require a large volume of short-term credit

in relation to their own capital. When beet deliveries commence, about the middle of September, the bank opens an agreed credit in favour of the factory. The factory, however, does not itself handle the money, but hands to the farmer a voucher for each load delivered showing weight, quality, price, etc., the sum of money represented by the voucher being paid out directly by the bank, frequently by a bank official who brings a supply of notes and opens a temporary office in the factory premises. Every five days the factory makes out a statement showing the total sums paid out, to which is attached a document somewhat in the nature of a promissory note as well as a bond securing the advance on the sugar beet delivered. As the beet is converted into sugar a new advance secured on the manufactured sugar is granted to cover manufacturing costs as well as the cost of the raw material, and the original advance against the raw beet is paid off. The reason for dividing the credit in this way is that two forms of credit are involved, viz. (1) a credit to purchase raw material and (2) a credit to finance a manufacturing process. The conversion of the first into the second maintains intact the principle that every credit is granted for a single and strictly defined purpose and must be repaid when that purpose is achieved. The credit is finally repaid as the sugar is sold. The sum advanced against the manufactured sugar is estimated to cover full production costs but not profits. The amount, however, represents a comparatively high proportion of the selling price. But as in the Soviet system prices are planned ahead and fluctuate if at all within negligible limits, the bank's security is normally quite sufficient. The factory's own capital serves as collateral security should it happen that the amount realised by the sale

of the sugar is insufficient to repay the credit. This, in the present shortage of commodities, could presumably only happen if a large quantity of sugar became spoiled through mishap.

§ 3. AGRICULTURAL CREDITS

State farms receive credit on very much the same lines as industrial enterprises, to cover seasonal requirements of working capital in excess of the minimum. In the case of grain farms the principal forms of credit are a general cash advance for harvesting operations and credits in spring for purchases of fuel and oil for tractors; seed and chemical fertilisers are purchased with the farm's own funds. Live-stock farms receive a general credit in the first quarter of the year, because maintenance is then most expensive and milk-yields small, and also during the two months when cattle are being fattened for slaughter. They also receive special credits for purchases of concentrated fodder in the fourth quarter; they are expected to supply all their bulk fodder themselves.

Short-term credit to collective farms is generally a matter for the State Collecting Organisations and the Machine Tractor Stations. The former give loans of seed, fertilisers, etc., in the autumn or spring and the latter supply tractors and machinery for autumn and spring ploughing, sowing, etc. Loans of seed may be repaid in kind, but usually advances in kind are repaid in cash when the following harvest is gathered and sold, while the services of the Machine Tractor Stations are paid for with a percentage of the resulting crop, varying according to the proportion of the cultivation carried out by the station's machinery.

Both the Collecting Organisations and Machine Tractor Stations receive advances from the Gosbank to finance their credits in kind or services to the farms. In such circumstances the farms have little or no need for routine seasonal cash credits. Medium-term credits for the purchase of live stock, farm implements, etc., are granted by the Agricultural Bank out of the farms' money deposited with it.

§ 4. COMMERCIAL CREDITS

Commerce, as distinct from industry, is by far the Gosbank's largest collective debtor on short term. In 1934, out of a total bank credit of R.14.2 milliard nearly R.10 milliard was granted to finance the movement and exchange of goods as distinct from their production. Of this R.10 milliard nearly R.4.6 milliard was advanced to finance the purchase of foodstuffs and agricultural raw material and R.3.9 milliards to the various retail systems. The collection, transport and storage of agricultural produce are seasonal operations and therefore can properly be financed by short-term credit. The distribution of consumption goods is less subject to seasonal fluctuations, but because many retail organisations do not possess sufficient working capital of their own, a very large part of their regular turnover has to be financed by the bank. This is contrary to Soviet banking principles, and to remedy the situation a law was issued in August 1933 providing in given circumstances for a transitory loan up to twelve months from the Gosbank to its commercial clients. During the twelve months they were to augment their own working capital till it coincided with their so-called "Normative"

“Normative” means simply the amount of liquid funds required by any economic organisation to cover its current turnover at the slackest period. The Normative of a trading enterprise is determined by a somewhat involved calculation. The total value of goods sold during the slackest month, less the value of goods of a purely seasonal character, divided by 30 gives the daily cash turnover. For example, if a given enterprise sells goods to the value of R.900 thousand in the month, including R.90 thousand worth of purely seasonal goods (fruit, vegetables and such perishables), its daily cash turnover will be $900 - 90 \div 30 = \text{R.27 thousand}$.

The planned period for the turnover of all trading stocks in hand is, say, 13 days.

The planned turnover period of all cash is, say, 2.5 days.

The planned turnover period of all other liquid assets consumed in the business (packing material, etc.) is, say, 2 days.

The Normative is the sum of the daily cash turnover multiplied by each of the turnover periods plus the average value of goods in transit, thus:

	(000 omitted)
27×13	= 351
$27 \times 2.5 = 67.5$, or rounded off	= 68
27×2	= 54
Average value of goods in transit	= 139
	<u>612</u>

Thus the official Normative for the enterprise in question would be R.612 thousand. Under the above-mentioned law the bank granted a transitory credit to any trading enterprise whose own capital and reserves, plus certain borrowed resources, covered its

fixed assets plus 10 per cent of the Normative for goods in stock and in transit and 100 per cent of the Normative for cash turnover and other consumable assets. For example, the above enterprise possessed in share capital (being a consumers' co-operative), reserves etc., R.270 thousand and in borrowed resources, consisting of a long-term loan, indebtedness in various ways to certain funds, deposits of customers, bank overdraft, etc., the amount of R.175 thousand. Its fixed or "non-turnover" assets, including buildings, securities, debtors on non-trading accounts, money or loan at long term, etc., amounted to R.235 thousand. Thus, own and borrowed capital had to amount at least to R.406 thousand, viz.:

	(000 omitted)
Fixed and non-turnover assets	235
10 per cent of the value of goods in transit (139) and of the Normative of goods in stock (357), in all R.490 thousand	49
Normative of cash turnover	68
Normative of other consumable assets	54
	<u>406</u>

Since the enterprise's own and borrowed capital actually amounted to R.445 thousand it was qualified to receive a credit from the bank to the amount of R.402 thousand, that is, R.612 thousand less R.210 thousand, the amount by which capital (R.445 thousand) exceeded fixed and non-turnover assets, viz. R.235 thousand.

The transitory credit was, of course, not intended to increase the recipient's ability to hold stocks. The primary use was to pay off existing short-term debts,

including advances from the bank. During the twelve months the enterprise was supposed to repay the special loan by increasing its own capital from profits, members' subscriptions, possibly a loan from the long-term Co-operative Bank, the proceeds of the sale of surplus property, etc. It would not be permissible for an enterprise to sell its holding of state loan in order to increase its liquid funds. Neither can state loan be lombarded. The twelve months for which transitory credits were to be granted expired at the end of August 1934, but to what extent the scheme was a success and how much of the total credit given was duly repaid was never published.

Enterprises whose balance-sheets could not come up to the standard required had to carry on under the old conditions, for the new system did not involve an automatic closing-down of ordinary credit facilities, until they could accumulate sufficient capital of their own. This was not such a serious task as it perhaps appears, for every trading enterprise, like industrial enterprises, belongs to a trust or some higher co-operative organisation which, in the long run, is responsible for its constituent units and must come to their assistance when their own resources fail. If, for example, a trading enterprise, having received a transitory credit, is unable to repay the whole sum at the due date, the Gosbank will prolong the credit for the necessary amount upon the guarantee of the higher organisation. The latter can also temporarily relieve an enterprise from paying contributions to various central funds and reserves so that it can more rapidly increase its own liquid capital.

When an enterprise has accumulated sufficient working capital to cover its Normative it should theo-

retically be independent of short-term bank credit so long as its trading turnover maintains a steady and uniform level of volume and period. In practice, of course, there are inevitable fluctuations due to various causes classified under three heads, viz. (1) normal seasonal fluctuations, (2) irregular deliveries by the manufacturers of trading goods and other supplies, (3) changes in the rate of turnover of goods after receipt. If through any of these causes the trading enterprise's own working capital is insufficient to cover its current requirements, it can apply for supplementary credit from the bank, so long as its credit quota is not exhausted. Seasonal fluctuations may be due to the necessity of laying in stocks of goods such as potatoes and other foodstuffs coming on the market at a particular time of the year. Such stocks are sold gradually and therefore represent a certain amount of liquid capital temporarily immobilised. In such cases the bank may grant a "special purpose loan for seasonal storage of goods". Normally, however, credit is granted in the form of "current credit for goods turnover" if the need of the advance arises from internal causes; for instance, an increase in the turnover period, which may be due to goods taking longer in transit to the enterprise's distant retail branches, or to a change in the composition of the stock in trade. The amount of credit then granted is the exact sum by which the longer turnover period increases the Normative. The period of the credit is based on the average turnover period of cash and stocks.

An enterprise's own working capital should correspond with the Normative calculated for a period of minimum activity, and to cover normal increases in trading it is entitled to a planned credit in the same

way as an industrial enterprise. In practice this means that advances are granted up to a fixed maximum to enable the enterprise to pay for goods received in excess of the normal minimum. In retail trade there are naturally busy periods, particularly in spring and autumn, and slack periods, for instance during the summer holiday season. The planned credit is designed to cover the additional turnover in the busy seasons, but it may happen that the suppliers of commodities, instead of keeping up regular deliveries every week or so, according to plan, deliver several weeks' orders in one consignment, and since the purchasing enterprise must pay on delivery it may be unable to find so much money on the spot even by drawing on its credit to the limit. In such a case the bank will grant a non-planned credit to the necessary amount for a strictly limited period. Strict rules are in force to prevent an enterprise double-banking its credit by drawing on its planned credit to finance purchases of seasonal stocks and at the same time obtaining a loan for holding the same goods in store.

The bank may stop credits and call in outstanding advances if an enterprise fails to repay its loans and advances at maturity or does not make punctual payments to its suppliers. Such conduct is held to be *prima facie* evidence that the enterprise has been immobilising its liquid resources or trading at a loss and therefore is unworthy of receiving further credit. In practice, considerable latitude is allowed and a warning will probably be given before these sanctions are put into force. It is also a rule that advances must be fully covered by stocks of trading goods. Should this security fall below the sum of outstanding credit, the bank calls upon the client to reduce his indebtedness.

CHAPTER VII

CURRENCY PLANNING

If prices are to remain stable, the value of currency in circulation should bear a more or less constant relation to the value of the flow of available goods. To determine the required flow of consumption goods a balance must be struck between the State's monetary income and expenditure, excluding clearing and other settlements in which cash does not change hands. A complete analysis of the income and expenditure would be too complicated and take too long to produce to permit of it serving as a current operative guide. Therefore a form of simplified analysis is made at monthly intervals. This is drawn up somewhat as follows:

<i>Income</i>	<i>Expenditure</i>
1. Taxes and levies.	1. Wage payments with money drawn from the bank.
2. Proceeds of loans.	2. Wage payments out of trading receipts.
3. Co-operative membership fees.	3. Economic operational costs.
4. Communal revenues.	4. Administrative costs of trading enterprise paid out of trading receipts.
5. Revenue from transport.	5. Payments on account of hired transport.
6. Revenue from communications.	6. Currency supplied by the bank for purchasing consumption goods.
7. Sundries, including savings-bank deposits.	7. Trading receipts devoted to the same purpose.
	8. Cash loans.

*Income**Expenditure*

9. Social insurance payments.
10. Savings-bank withdrawals.
11. Transfers.

The total of expenditure will invariably exceed the total of revenue, and the difference indicates the volume of consumption goods, the value (selling price) of which, in any given region in a given period of time, will correspond to the quantity of currency available for purchases. The corresponding flow of goods is the exact amount which will satisfy the effective demand of the public. If, during a period, the value of goods sold is greater than the net monetary income received by the consuming public, it indicates that money saved in a previous period has been used to buy commodities. During a period in which money savings are increased the sale of goods will not equal the difference between national expenditure and revenue.

Currency is employed almost exclusively for making payments to individual citizens, payments, of course, being preponderatingly wages or in the nature of wages. Therefore, if the total amount paid out during a given period in wages and remunerations be known and the sum collected from or paid by the people in taxes, travelling, postage, loan subscriptions and so on, be also known, the difference must represent the amount of total purchasing power available for buying goods.

In practice, every regional financial organ, either the local office of the Commissariat of Finance or the local branch of the Gosbank, makes an analysis as above of the estimated cash situation in its territory for the coming period. The primary object of the analysis is to determine the total value of consumers' goods that should be made available, and this in turn is a guide to

the amount of credit that should be distributed to the various retail organisations supplying the wants of the population. But it also indicates the amount of currency the regional branch of the Gosbank will be called upon to provide. Most of the currency drawn from the bank for wage payments, etc., is redeposited by the various organisations providing goods and services to the population, the tax authorities and the savings banks from money deposited by individuals or paid in as loan subscriptions. A comparatively small proportion of the total circulation remains as till-money in the savings banks, public offices, post office, retail shops, etc. If the average rate of turnover be correctly estimated or, rather, if it corresponds with the rate laid down in the regional finance plan, the bank can fairly accurately calculate in advance whether its existing stock of notes and coin will be sufficient, whether it will have to draw additional supplies from the head office or will be able to withdraw currency from circulation. The returns from all branches are received by the head office in Moscow, which is thus able to calculate whether the net requirements of the whole country demand an increase in the circulation or the reverse. Since the annual Plan for the production of goods and the annual Finance Plan are drawn up in correlation with each other, the importance of fulfilling the Finance Plan is obvious, for any deviation will bring about unplanned movements in the retail price level. This explains the continual and monotonous propaganda in the press, particularly in the organ of the Commissariat of Finance, stressing the importance of every province and district fulfilling its official finance plan, in other words, of punctually collecting taxes, loan subscriptions and increasing savings-bank deposits.

CHAPTER VIII

THE ACCOUNTING SYSTEM

§ 1. DEBT SETTLEMENT

EVERY state and co-operative enterprise and all non-economic organisations, such as scientific and educational institutions of any importance, keep an account at a branch of the Gosbank. Industrial and commercial enterprises normally have a current account and what is called a "Raschotny" (literally, "reckoning") Account. The former is merely a cash account from which sums in cash are drawn for wage payments and other disbursements demanding ready cash. The latter might be described as a giro or cheque account, though cheques are little used. Through this account pass all payments and receipts except when actually currency is handled. As a matter of fact all commercial transactions save those involving comparatively insignificant sums are settled by entries and counter entries in the books of the Gosbank. For cash requirements sums are transferred from the giro account to the current account. The giro account, therefore, reflects the actual position of an enterprise at any given moment, for all debts are settled at once. If the account is in debit it follows that the enterprise is in debt to the bank for that amount.

Credit accounts are opened only for those clients who have been granted a credit quota under the Finance Plan. The total quota is subdivided into

subsidiary quotas for each specific class of credit; for example, a client who has a credit limit or maximum of R.10,000 may have this subdivided into R.5000 for raw material, R.3000 for fuel and R.2000 for some other purpose. For each subquota a separate account is opened in which are entered all sums advanced for that particular purpose and repayments when made. In special circumstances an exhausted quota may be supplemented by transfers from an unexhausted quota, but only by special permission of the bank.

Enterprises' own working or turnover capital is also allotted in quotas to specific purposes, hence it can happen that a client of the bank may, on balance, be in credit, but, having exhausted his own funds and his credit quota for a special purpose, be unable for the time being to make any more purchases of certain requirements. The object of these various restrictions is to enforce what is known as financial discipline. The control thus exercised by the bank enables it to prevent money being employed for unplanned purposes such as the accumulation of unnecessarily large stocks or reserves of material or goods, the employment of excessive labour, etc. The system is also calculated to reduce the need of currency to a minimum.

The technical methods of settling debts under this system is by "acceptances", "accreditives" and "special accounts". Under the "acceptance" method, prior to 1st August 1935 the supplier of goods at the time of despatch made out a priced invoice in triplicate, of which two copies were sent to the consignee and one copy to the consignee's branch of the Gosbank. Before obtaining delivery of the goods the purchaser had to "accept" a copy of the invoice and hand it to his bank. The "acceptance" consisted of stamping the word

"accepted" across the face of the invoice with the signature of the responsible manager. Upon receipt of the accepted invoice the bank debited the purchaser's giro account, making a corresponding credit entry in a so-called "goods turnover account". The purchaser's bank then returned a copy of the invoice to the consigner's bank together with a record of the payment. In due course the consigner received from his bank a notification that his account had been credited, and his bank completed the transaction by debiting its "goods turnover account". The goods turnover accounts had their counterpart in the branch banks clearing accounts at the head office, and through corresponding entries in these the necessary clearing was effected.

Until payment by the consignee was in order, that is, the invoice had been accepted and the bank had certified that the consignee had funds to meet the account, the railway or other transporting organisation could not surrender the goods, unless these were perishable. If, through lack of funds or the refusal of the consignee to take delivery or for any other reason, payment was not made, the consigner was given five days in which to make other dispositions. If the consigner neglected to give instructions at the expiry of five days, the consignee's bank proceeded to sell the goods to another buyer.

There were several drawbacks to this system. In the first place, every supplier of goods dealt direct with his customers and their branch banks, his own bank having nothing to do except credit his account upon advice from the buyer's bank. Owing to the prevalent ignorance and inefficiency of the clerical staff in most enterprises, invoices were frequently incomplete or

contained errors and were returned by the buyer for correction. In the second place, a buyer's bank would usually be less energetic in looking after the interests of some distant enterprise than those of its own clients, and since the Gosbank is a powerful and autocratic institution, the distant creditor was often unable to get any action taken against an unsatisfactory debtor. In any case there were often delays in getting payment for goods delivered, because correspondence takes an unconscionable time to be delivered by the Soviet post offices.

Under amended regulations introduced on 1st August 1935 the seller makes out an invoice for the buyer containing full specifications and prices as before, but this is no longer a financial document in the same way. It does not combine the functions of an invoice and a bill or demand for payment. The seller draws, in addition to the invoice, what in effect is a sight draft on the buyer and hands it in triplicate, together with a copy of the invoice, to his own bank. One copy of the draft furnished with the bank's stamp is returned to the client, who forwards it to the buyer. Another copy of the draft, together with the copy of the invoice, is then forwarded by the supplier's bank to the buyer's bank and the third copy is retained for reference. The buyer accepts the draft received from the seller and hands it to his own bank as authority to debit his account. The reason for this is that if it is an invariable rule that debtors accept only drafts furnished with the stamp of the creditor's bank, of which there can be only one copy, the chance of making payment twice over for the same shipment is eliminated. The copy received by the buyer's bank is merely for reference and information, while the copy retained by

the seller's bank enables it to identify and check the transaction.

Essentially this method of collecting payment is similar to that in which a capitalist shipper hands invoice, bills of lading, etc., together with a draft on the buyer to his bank for collection. It is only a matter of detail and convenience that the debtor accepts the draft received direct from the seller and not the copy sent to his own bank. The bank is supposed to be the supreme authority and general supervisor of all accounting and financial transactions, and if an invoice contains any errors it is the duty of the bank to see that corrections are made. Thus the delay caused by the buyer returning an invoice for correction is avoided. The bank must also satisfy itself that the drafts handed in by sellers are based on genuine exchanges of goods at the controlled or fixed prices and are not finance bills drawn as a result of some secret and illicit understanding between drawer and drawee. The supplier has the advantage of dealing only with his own branch bank and not with a number of distant branches. His own bank will naturally look after the interests of its clients and is far better qualified to deal with other branches of the bank, which is of course part of its business, than the client whose real business is manufacturing or trading. If for any reason payment is refused, the draft is "protested" and the buyer must substantiate his complaint before an arbitrator.

This system of bank collection of debts involved some alterations and to some extent simplified the method of granting transit credit. Planned credit, as was described in Chap. II, is granted solely to the buyer, never to the seller of goods, so that in principle the supplier always receives cash. But there is a time-lag

between the despatch of goods and receipt of payment, and because goods and money turnover are so strictly planned and because few, if any, enterprises possess any surplus turnover capital for emergencies, a seller usually must receive payment at the time goods are despatched. It may, however, be a matter of two or three weeks or even more before payment can be received from the buyer. A seller therefore may apply for a transit credit from his own bank on showing proof that a consignment has been despatched. The usual way is by handing in a copy of the invoice. But, as explained above, the supplier's bank formerly had nothing to do with collecting payment and had to take the invoice on trust. The duration of the credit was determined by the estimated time taken by the invoices to reach the consignee, be checked and accepted, and advice received from the consignee's bank that payment was in order. It was, apparently, not unknown for a supplying enterprise to submit faked invoices in order to get credit in a financial emergency. Under the new system the supplier can only obtain transit credit against genuine shipments, because his bank will only grant him a credit on the strength of documents handed to it for collection, which incidentally will show the actual date on which the goods were despatched. In principle this is somewhat similar to the capitalist system of making an advance against a sale of goods. The credit is repayable in the ordinary course of events when the supplier's bank receives advice from the buyer's bank that payment has been effected, but if for any reason the draft is dishonoured the credit is at once revoked. Thus there is no question of a credit on the security of the goods themselves. Such a thing as lombard credits do not exist in Soviet commerce,

though in certain circumstances advances can be made to public bodies such as municipalities on the security of real property.

Under the "accreditivè" system the purchasing enterprise instructs its branch bank to open a credit in favour of the supplying enterprise at the latter's branch. Under the terms of the contract between purchaser and supplier the latter receives payment from this credit upon presentation of the invoice, way-bill and other documents relating to the goods despatched. The contract may stipulate for formal acceptance of the invoice by the purchaser before payment is made, but acceptance and inspection of the goods by the purchaser is not essential. An "accreditivè" can only be opened in respect of a specific consignment, which must have a minimum invoice value of R.1000, and is only valid for at most twenty-five days. If not used within this period, it lapses.

When one enterprise is a permanent contractual supplier of goods to another, pre-eminently in the case of suppliers of coal, coke, ore, etc., to heavy industry, the buyer may open a special account at his bank from which all payments are automatically made for deliveries under the contract.

Payments between enterprises in the same town may be effected by cheque or by orders for payment on the bank of the payer in favour of the payee. Should the payer's account not be in sufficient funds to meet a cheque, it is returned dishonoured to the payee. In a similar case an order is not dishonoured, but payment is suspended until the debtor's account is in funds. When creditor and debtor have accounts at the same bank, the account is settled by book entries. Should the creditor and debtor have their accounts at different

branches in the same town, the creditor must present the cheque at the debtor's bank and receive payment in cash. If the paying bank has insufficient ready cash to meet all the cheques presented, it issues so-called "valutirovanny" cheques,¹ equivalent to a certified bank cheque. Certified cheques are now scarcely if at all used, and payments, except for comparatively trifling amounts, are effected in the normal way by means of accepted invoices. There is no system of cheque-clearing between various branches of the Gosbank. But a kind of clearing system for adjusting payments may be employed in places where two or more enterprises have close and constant commercial relations. This consists of a periodical adjustment of balances through a special department of the local bank, known as the department of mutual accounts, and thus separate payments for each transaction are rendered unnecessary.

Payments by enterprises and institutions for communal services, water, electricity, telephones, etc., are made automatically by the bank debiting the account of the payer on advice from the supplying authority. It is considered that since there can be no dispute regarding such accounts, the sum due being automatically registered by meters or being a fixed amount, it would be merely a waste of time to present accounts to the payer. Payment for work done by contractors

¹ Valutirovanny cheques were introduced as a method of economising currency when the circulation was expanding to an undesirable extent. These cheques formed a sort of subsidiary currency and were extremely unpopular. Not infrequently institutions with large pay-sheets, such as the State Opera with 2000 artistes and employes, received part of their salary requirements in valutirovanny cheques. The necessary roubles to pay salaries could only be procured by finding some institution or enterprise willing to buy the cheque at a not too exorbitant discount.

on construction, installations, etc., is effected by accepted accounts, but if the debtor neglects to accept or protest against the account within a very limited time, his bank will automatically debit his account and transfer payment to the contractor.

§ 2. PRICE-FIXING AND CONTROL

Wholesale prices, that is, the prices at which material and goods are exchanged between enterprises, are calculated by adding to the primary cost of the raw material the cost of manufacture, and the handling charges and "profit"¹ of every organisation through whose hands the goods pass. In addition, the price of finished goods includes the turnover tax, which ranges from about 5 to 80 per cent of the wholesale price. The amount of the tax is usually added to the price when goods are sold by the manufacturers' syndicates to the wholesale organisations of the retail system. In practice the Government Price-fixing Committee calculates the price of certain standard qualities of different classes of goods, and these prices form the basis for negotiations between the manufacturing and trading interests concerned regarding the prices for all intermediate types and qualities.

Soviet factories possess trade-marks just as in pre-revolutionary Russia, and it may and in fact does happen that a certain mark, for instance of cotton goods, earns a reputation for good quality. This is of no immediate material advantage to the manufacturing

¹ Under the Soviet system of planned production costs and fixed prices profits consist of a planned percentage added to gross production costs to arrive at the fixed selling price. The manufacturing or trading profit of an enterprise is therefore planned in advance.

enterprise since the fact of its goods being preferred cannot be exploited, though if its goods are obviously superior to the same class produced by other enterprises, a slightly better price may be obtained.

Prices on the open peasant market are determined by supply and demand and the prices at which similar goods can be bought in the state and co-operative shops is an important factor. Prices paid for peasant produce apart from the compulsory deliveries by state and co-operative organisations are subject to a maximum limit on the understanding that manufactured goods will be made available to the full values of the produce sold. Legally there is no compulsion on the peasants to sell, and their willingness to part with their surplus foodstuffs at these controlled prices depends on whether the undertaking to provide manufactured goods is fulfilled or not.

CHAPTER IX

THE SOVIET BANKING SYSTEM

§ 1. THE STATE BANK

THE Soviet banking system consists of the State Bank or Gosbank, four long-term investment banks, viz. the Long-term Bank for Industry or "Prombank", the Central Bank for Municipal Economy and House Building or "Tzekombank", the All Union Co-operative Bank or "Vsekobank", the Agricultural Bank or "Selkosbank", and the Savings Bank. All banking institutions are state enterprises closely linked with the People's Commissariat of Finance. In a closed and planned economy the structure and functions of credit institutions are necessarily different in many ways from capitalist banks; but it is noteworthy that the Soviet economists and financial experts have not succeeded in evolving a new financial system, rather have they adapted the technique and methods of the capitalist system to their own peculiar needs.

The Gosbank is the Central Bank and the sole source of short-term credit; it was formed in 1921 as the State Bank of the R.S.F.S.R., and renamed the State Bank¹ of the U.S.S.R. in 1923. Its constitution is based on statutes which follow very closely those of other central banks, but in practice many clauses are

¹ The term Gosbank is merely a contraction and amalgamation of Gosudarstvenny Bank. Since the long-term banks are also state banks the use of Gosbank instead of State Bank seems preferable.

at present quite inoperative; for example, provision is made for discounting bills and granting loans against the security of various bonds, but under the credit system in force bills are not used, and credit is only given on open account as explained in Chapter II. The bank has its own capital of R.600 million, subscribed by the State, and is theoretically a separate legal entity, operating independently on a commercial basis; but even in the statutes provision is made for its activities to be supervised by the Commissariat of Finance, and in practice it is little more than a very important department of that organisation. Its administration consists of a council and a Board of Directors; the former is composed of—

The Commissary for Finance, who acts as Chairman.

The Chairman of the Board of Directors.

The Chairmen of the four long-term banks described above.

The Chairman of the Bank for Foreign Trade.

Members appointed by the Government to represent different branches of the national economy.

One representative from each Federated Republic.

The Board consists of a chairman and vice-chairman appointed by the Government, and at least seven members nominated by the council and confirmed by the Commissariat of Finance.

The statutes confer on the Bank the sole right of issuing bank-notes, and provide for a separate issue department, which issues periodic returns showing the amount of bank-notes placed in circulation, and their cover. They also lay down that all credit institutions, with minor exceptions, must keep their free cash

reserves with the Gosbank, and give it the right to accept deposits in foreign currencies—though these are in practice confined almost exclusively to foreigners.

The Bank's net profits are distributed as follows: 50 per cent to Treasury revenue, 5 per cent to staff welfare, not more than $\frac{1}{4}$ per cent to the bonus fund, and the remainder to reserves. The latter are to accumulate until they equal the statutory capital; no returns of the banking department have been published since May 1932, when the reserve stood at R.302 million.

The central administration of the Gosbank is naturally in Moscow, and as in all central banks, this deals with matters of general policy, but in the Soviet's planned economy both its problems and methods are peculiar to the environment. The principal department is that for general credit planning, which has subsidiary sections for every branch of national economy. The other main branch of the central administration is the foreign department, which deals with general matters of policy, relations with foreign banks, etc. The technical work in connection with financing foreign trade and making payments abroad is done by the Bank for Foreign Trade. As this is situated in the same building and is simply an agent carrying out instructions, it may best be regarded as the executive side of the Gosbank's foreign department.

Under the central administration is the central head office, at which clearing accounts are kept by each of the 43 regional and provincial head offices (one of which is in Moscow, and at least one in each autonomous republic) and the 2400 branch offices and agencies. The function of the central head office is to serve as a clearing-house for all banks in the Union; the regional

head offices do some ordinary banking work, but their main purpose is to act as a link between the central administration and the branch offices. They perform much the same functions in the preparation of the credit plan as the trusts do in the industrial plan, and assist in its execution by giving decisions on questions of lesser importance; they also act as clearing centres for transfers between branches within their region. The individual branches carry out ordinary routine banking operations. Every institution and enterprise must keep its current account with its allotted branch. Private accounts are not admissible; for individuals the Savings Bank is the only institution where an account can be opened. Every branch is financially independent and presents its own balance-sheet and profit-and-loss account; it derives its revenue from the interest and commissions it charges to borrowers, out of which it must meet all its expenses. No interest is allowed on the clearing balances which every branch must keep at its regional office and at the head office.

Branches of the long-term credit banks are opened wherever there is sufficient capital development in progress to warrant it. In places where there is no branch the local branch of the Gosbank acts as agent sometimes with and sometimes without attached commissioners representing the long-term credit banks.

Where there is no branch or representative of the long-term credit banks the local branch of the Gosbank carries out all financial operations, accepting deposits, collecting sums due and paying out money on behalf of the other banks. When paying out money the Gosbank supervises expenditure on behalf of the long-term credit bank concerned, for which purpose the latter supplies copies of price-lists, estimates

and other documents relative to the work being financed.

Where there is a commissioner of a long-term credit bank he is responsible for all credit operations, checking estimates and prices, and generally controlling the expenditure of money issued for financing capital construction. In such circumstances the Gosbank carries out only ordinary current account and cash operations on behalf of, and under agreement with, the long-term credit bank.

In centres where there are branches of a long-term credit bank the Gosbank, under instructions, carries out all the former's actual cash operations; for, except in the case of local communal banks, none of the long-term credit banks handle cash, but make all payments by means of cheques or orders drawn on the local branch of the Gosbank.

The Gosbank charges the Tsekombank and the Vsekbank interest at 5 per cent per annum on their debit accounts, and, in the case of the latter, pays the same on credit balances but also takes a commission of 1 per cent on the total turnover.

§ 2. THE SAVINGS BANK

The State Savings Bank is under the direction of the Commissariat of Finance. The head office and administration are situated in the central Gosbank building in Moscow; its thousands of branches (about 60,000) are attached to the offices of local finance departments, branch offices and agencies of the Gosbank, post and telegraph offices, railway stations, factories, village clubs, etc. The Savings Bank is the only institution in which the deposits of private

individuals are accepted. On private accounts interest is paid at the rate of 8 per cent per annum, while on the deposits of institutions the rate is 6 per cent. On fixed-term deposits the interest rate is 1 per cent more in each case. Both deposits and interest are exempt from stamp duty and income tax. The Savings Bank has in recent years introduced a system of clearing by which depositors can effect payments of accounts for rent, water, gas and other public utilities and for making remittances to distant places. One of the Savings Bank's most important functions, however, is to mobilise the resources of the people for investment in state loans, investment in which, though nominally voluntary, is in fact almost compulsory. Owing to the urban housing shortage and consequent lack of privacy, most officials, employees and workers deposit their salaries or wages in the Savings Bank in preference to carrying the money about on their persons. On 1st September 1935 Savings Bank deposits totalled about R.2100 millions.

The Savings Bank branches keep from 10 to 50 per cent of their sight liabilities in liquid cash. The lower percentage obtains in city offices, where any unusual demand for cash can be covered by immediate recourse to the nearest office of the Gosbank. In outlying districts, where the Savings Bank branch probably acts as local agent for the Gosbank and other financial institutions, and where it would take days to obtain a fresh supply of currency, the ratio of liquid cash to deposits is necessarily much greater.

The whole of the Savings Bank's liquid assets, with the exception of till-money, is invested in a special *tranche* of the State Loan. It is understood that the interest on Saving Bank funds lent to the State is

higher than that paid on the ordinary State Loan bonds; as it would, of course, need to be to cover the interest on Savings Bank deposits. But the precise terms on which the Savings Bank invests its funds are not made known.

CHAPTER X

THE DISTRIBUTION OF CAPITAL FUNDS

§ 1. THE PROMBANK¹

THE four long-term or so-called Special Banks mentioned in the previous chapter attained their present forms as the result of a decree issued on 5th May 1932 reorganising the whole system of long-term capital investment. Their functions are to administer and distribute budgetary grants for national economic development and to collect and redistribute as long-term loans or grants a proportion of the profits and reserves of their clients. In all operations the banks are strictly bound by the Finance Plan, in the execution of which they also take an active part as financial controllers and auditors.

All state enterprises, not only industry but transport, building generally, foreign trade and the cinema industry, in fact every form of economic activity coming directly under a People's Commissariat, receive capital investment funds through the Prombank, not as loans but as grants. This system is of recent origin, actually dating from the decree issued in May 1932. In 1925 the Soviet Government first began to devote serious attention to financing a more rapid development of economic resources and the restoration of existing industry, and in 1927 a department of long-

¹ *Promyshlennost* = industry; *Promyshlenny Bank*, abb. *Prombank* = Industrial Bank.

term credit was established in connection with the Prombank, which at that time was providing all normal banking facilities for industry and was not a purely long-term institution. The department was charged with administering a fund consisting of budgetary grants, allocations from the profits and amortisation reserves of enterprises and from the profits of the Prombank. In 1928 the department, retaining the name of the Prombank, was converted into an independent long-term credit bank for the issue of non-repayable grants and interest-bearing loans with a maximum term of thirty years.

Through successive stages the system of financing economic development diverged more and more from the traditional capitalist methods. When central state planning was introduced, long-term borrowing for capital investment clearly could not be fitted into the new system. To carry out the maximum development of national economy a maximum mobilisation of industrial accumulation (i.e. profits including appropriations to reserves) was necessary. This could be efficiently done only by a centralised system of collecting and redistributing national accumulations; in other words, by passing a preponderating part of the national income through the budget. As a legacy of the old system the Gosbank still held in 1934 a certain quantity of 2½ per cent 10-year bonds, resulting from the funding of frozen advances made to long-term credit institutions prior to 1931.

Since May 1933 the reorganised Prombank has been the only source of capital investment funds for state organisations. Though called a bank it should be described as a department of the Finance Commissariat for the technical execution of the Government's plan

of capital development. Its function is to administer the funds set aside under the Plan. Its responsibility does not end with paying out the sums allotted to the various recipients; its duty is also to supervise all details of expenditure as laid down in the Law of 11th May 1933 for "*the control by Long-Term Credit Banks of the finance of Capital Construction*". Thus:

I. In financing capital construction Long-term Credit Banks shall:

- (a) Grant funds for financing only construction for which plans and estimates have been properly authorised and approved.
- (b) Pay accounts for building material and local transport strictly in accordance with the authorised prices and tariffs.
- (c) Pay accounts for installations strictly on the basis of prices fixed by contract or current price-lists.
- (d) Issue cash for the payment of labour only within the limits of the authorised expenditure.
- (e) Issue funds for preliminary expenses, administrative costs, scientific research, etc., according to approved estimates.
- (f) Pay accounts accepted by the Principal for constructional and installation work completed by the Contractor according to prices laid down in the contract between the Principal and Contractor.

II. A Bank must discontinue financing any construction the expenditure on which has exceeded the estimates as approved by the People's Commissariat or the combine or trust, or on which the

authorised quarterly expenditure has been exhausted.

In actual practice, the Prombank only pays out actual cash to its clients for wage payments and small disbursements. Accounts for material, contractors' claims and transport are paid direct to the payee. When cash is issued to the client-enterprise precautions are taken to secure that the money is used for the designated purpose and not diverted to improper uses; for instance, for purchasing raw material for the manufacturing side of the business. In large-scale constructional work the bank will probably open a temporary office on the premises and install its own staff to check wage-sheets, invoices, etc., and keep costing accounts and make the necessary payments, which are normally made by cheques or transfers on the State Bank. Sometimes when large constructional work is in progress far from any banking centre, the Prombank perforce has to provide currency on the spot for wage payments, etc., and will then open a temporary cash office, most probably in conjunction with a branch of the Savings Bank. The bank's responsibility does not extend to carrying out technical surveys of material and work done, which is a function of the Commission of Soviet Control.

The funds for capital investment are derived from—

- (1) Budgetary grants.
- (2) Industrial profits.
- (3) Industrial amortisation reserves.

The amount of the budgetary grant is fixed by the annual Finance Plan. The Plan also includes estimates of the sums to be received from industry, but the

amounts actually received depend on realised profits. The budgetary grant forms about 80 per cent of the sums allotted to economic development.

The first charge on all industrial profits is the State's share or dividend. A further proportion of net profits is deposited in the Prombank as a compulsory contribution to the general capital development fund. The balance of profits and sums allocated to amortisation reserves are deposited in the Prombank in the name of the trust or combine, and, to a smaller extent, in the name of the individual enterprise. The aggregate deposits of the constituent units of a trust or combine are known as centralised deposits; deposits by individual enterprises as decentralised. To a very limited degree individual enterprises may exercise their own discretion in the employment of their own deposits. In point of fact these funds are mainly used for increasing the enterprise's own turnover capital. A part may be used for adding to or improving the social amenities of the workers, but such expenditure depends on whether the enterprise has made more than the standard planned profits. The principle is that profits depend largely on the industry and efficiency of the staff and workers, who are entitled to benefit by bonuses and better living conditions if, through their efforts, the enterprise earns extra profits.

Centralised deposits are at the disposal of the trust or combine, which, within the framework of the Plan, distributes the money among its several enterprises. While capital extension may have to be restricted if profits are below expectations, it cannot be increased as a result of high profits without express authority. If the funds accumulated exceed the amount required to carry out the planned investment, the surplus serves

to help other enterprises whose requirements are not covered.

A word of explanation is perhaps necessary concerning "capital" repairs. Broadly speaking, capital repairs implies anything in the nature of rebuilding, reconditioning and replacements necessary at fairly long intervals, while "current" repairs includes annual or even more frequent overhauls, replacements of spare parts, etc. Current repairs, as is natural and proper, are included in normal working costs and are covered by the individual enterprise out of its ordinary revenue. Capital repairs are provided for in the amortisation funds which are concentrated with the trust or combine and redistributed among the individual enterprises according to their needs, at the discretion of the central organisation and in accordance with the annual Plan for capital repairs. Such centralisation is necessary under the planning system, otherwise the development and efficiency of the several constituents of a trust would tend to become unequal. There is another consideration which probably carried considerable weight; that is, the rather common lack of a sense of financial responsibility among factory managers. There is the fear, probably too often justified, that if an individual enterprise were allowed to accumulate considerable reserves under its own control the funds would be diverted to other than the designed purpose. This is all the more likely since the demand for constructional material, installations and raw material on the whole is always in excess of the available supply, and in spite of strict price-control it is generally possible to get hold of additional quantities by paying a premium on the fixed price.

§ 2. THE COMMUNAL BANK

The Tsekombank,¹ or the All Union Bank for financing communal and dwelling-house construction, unites all republican and local communal banks which, while retaining their separate identities, are the local agents and representatives of the Tsekombank.

The Tsekombank, including the whole system of local communal banks, finances, generally speaking, the construction of all dwelling-houses, scientific, educational, social, medical and health buildings and municipal or communal enterprises such as waterworks, sewerage, roads, etc., with the exception of any building or construction directly belonging to and undertaken by industrial enterprises for their own technical needs, or public services such as water and sewerage constructed exclusively to serve the needs of an industrial or transport enterprise. All construction of this nature is financed by the Prombank. Neither does the Tsekombank play any part in financing buildings for the benefit of the agricultural population. This comes under the Agricultural Bank.

Besides financing the above new construction, the Tsekombank and the communal banking system generally grant medium-term loans of from one to five years for financing the repairing and reconstruction of buildings, etc.

The means for financing the construction of workers' dwellings consist of the bank's own funds specially earmarked for that purpose, the capital funds of the autonomous Republics and Regions for financing workers' dwellings, and the capital funds of municipalities, workers' colonies and the like. These funds origin-

¹ *Tsentralny Kommunalny Bank.*

ate in budgetary grants, appropriations from the funds formed by commercial and credit institutions, and organisations for improving the living conditions of their workers and employées; appropriations from the net profits of state insurance; special supplementary charges on social insurance contributions and levies on social insurance funds; repaid loans and interest on loans; special taxes on municipal undertakings, *e.g.* 25 per cent of the gross revenue of electric supply enterprises and 35 per cent of the gross revenue of tramways and waterworks.

The funds for financing communal enterprise are derived from annual grants from the national budget, levies on the gross revenue of communal enterprises, grants from insurance funds, repayment of loans originally granted out of state funds, interest on loans and appropriations from the bank's own profits. The funds concentrated in the communal banking system from the above sources form a general pool from which loans and grants are issued irrespective of the organisations from which the money was received.

The bank also receives 75 per cent of the statutory sums set aside by all industrial undertakings for the improvement of workers' living conditions. The money thus accumulated in the bank is specifically used for building workers' dwellings in connection with the enterprises from which it was received. It also administers building funds formed by appropriations from the profits and amortisation reserves of all economic organs, direct grants from the Central Insurance Administration, principally derived from health insurance, and the share capital of building co-operatives.

Finally the Tsakombank administers special grants

from the national budget for dwelling-house construction.

In main principles the financial methods and operations of the communal banking system are comparable to those of the Prombank. But the funds of the Tsekombank are derived from a greater number of sources, including budgetary grants, special levies and taxes on the enterprises and organisations belonging to the communal system, as well as compulsory deposits from its clients. As in the case of industry, the bulk of the money accumulated in the bank goes into a general pool for financing planned construction under the Plan and only a comparatively small proportion of deposits can definitely be reclaimed by the depositors for their own purposes. A certain and relatively small part of the general funds are held by the local communal banks for financing their own local clients, but by far the bulk of the financing of communal and municipal construction comes directly under the national planning system.

The chief distinction between industrial and communal long-term finance is that the latter consists partly of long-term interest-bearing and repayable loans. Funds derived from certain sources are used to finance capital construction by non-repayable grants; other funds are issued as long-term loans having a maturity of from 20 to 60 years and carrying interest according to an official scale. Broadly speaking, non-repayable grants are made from money received by the bank on account of compulsory levies, contributions, etc., and a part of the budgetary subsidies. Repayable loans are made from funds having more the character of deposits, though the depositor has little, if any, control of his money, budgetary funds lent, not don-

ated, for financing communal development and the bank's own capital and reserves. In no case do depositors receive interest on their money. There is no freedom of choice in banking; all enterprises and institutions must keep their liquid or turnover capital at the Gosbank, and all their savings and reserves at their appropriate long-term banks. In so far as communal enterprises have a right to reclaim their own deposits for their own investment purposes, the project, whatever it is, must be approved by some planning authority and be within the framework of the National Plan.

The Tsekombank, in certain circumstances, grants short-term loans to enable enterprises to carry out the preliminaries to new capital construction, e.g. preparation of plans and sites and preliminary acquisition of material. Such advances are later merged into the long-term loans or grants.

The technical work of the Tsekombank is very similar to that of the Prombank. It exercises the same sort of control and check on the expenditure of its clients. Its part in drawing up the annual plan of communal capital construction is relatively more important than that of the Prombank, owing to the more decentralised nature of communal enterprise and the greater difficulty in correlating the constructional and financial sides of the plan. The financial plan in practice is drawn up with a certain margin, the maximum representing the amount of finance each client may claim if total funds suffice. If the maximum credit is not forthcoming, construction has correspondingly to be curtailed.

The Gosbank carries out the cash operations of the Tsekombank in the same way as for the Prombank,

except that the local communal banks execute current cash account operations for their communal enterprise clients.

§ 3. THE CO-OPERATIVE BANK

The Vsekobank,¹ or All-Union Co-operative Bank, emerged on 5th May 1932 as the result of the reorganisation of the existing All Russian Co-operative Bank. The function of the bank is to provide investment funds for promoting co-operation among the working masses, the capital needs of co-operative trade, small-scale production of consumption goods and the socialistic reconstruction of the workers' living conditions. The Vsekobank grants long-term finance in the form of loans or non-repayable grants for all co-operative capital construction with the exception of dwelling-house building; it also grants long-term loans to provide co-operative organisations with working capital and short-term credits for the external trade activities of *Centrosoyus* (the central organisation of the consumers' co-operative system).

By special decree of the Commissariat of Finance the Vsekobank also finances the capital needs of suburban food production (vegetable gardens, etc.) and of the Department of Workers' Supplies, and the capital expenditure of the Committee of the Council of People's Commissars for the collection of agricultural produce (excluding grain collections). In 1933 the bank distributed about R.1000 million, of which 30 per cent was granted to consumers' co-operatives, 24 per cent to industrial co-operatives, 28 per cent to the Department of Workers' Supplies, and 11 per cent to the Committee for the Collection of Agricultural

¹ *Vsesoyuznyy Kooperatsionnyy Bank.*

Produce. Of the total sum about 84 per cent was granted for capital investment and about 11.5 per cent for supplementing working capital, mainly to industrial co-operative enterprises.

In the bank are concentrated all funds destined for the capital construction and other long-term investment needs of all co-operative enterprises, as well as the government funds entrusted to it for financing the Department of Workers' Supplies and the Committee for the Collection of Agricultural Produce.

The share capital of the bank is fixed at R.40 million. The shareholders are all sorts of co-operative enterprises and organisations as well as state organisations in which there is a preponderant amount of co-operative capital. The chief shareholders in regard to the amount subscribed are the consumers' co-operatives. The capital, when once subscribed, can only be repaid to the shareholders in the event of the bank being liquidated. The reserve capital of the bank is formed by appropriations of not less than 10 per cent of its net annual profits and serves to cover any possible losses sustained by the bank. Special funds for financing capital investment are formed by appropriations from the bank's capital or, in agreement with state co-operative organisations, by appropriations from their special purpose deposits.

Special credits are given by the bank for periods of not more than eighteen months for financing the export and import of goods by Centrosoyuz. In connection with its external trade operations the bank carries out accreditive operations and collects bills, drafts, etc., in foreign currencies. The bank itself is a co-operative organisation and, being also a credit institution, comes into the system of the Commissariat

for Finance, which exercises a general supervision and control over its activities. The bank's activities extend over the whole territory of the U.S.S.R., in which it has 19 offices, 6 branches and 18 authorised agents. The administrative control of the bank is vested in the assembly of representative shareholders, together with representatives of the Government.

All consumers' co-operatives have to make contributions to the funds for long-term credits for capital construction as well as for working capital. These contributions are formed from levies on the net profits of the organisations. They are not reclaimable by the depositors nor is any interest allowed on them. A second group of funds consists of special deposits by consumers' co-operatives according to a predetermined plan, from increases in co-operative societies' share capital, from special contributions from co-operative members and from amortisation funds. The money thus received is repayable to the depositor and can only be advanced to consumers' co-operative associations for certain defined purposes, the conditions covering payment and repayment being fixed by Centrosoyuz in agreement with the bank. A third group of funds consists of deposits by non-co-operative organisations such as trade unions and state industrial and commercial enterprises, and also of grants from state and local budgets. The funds at the disposal of the bank on 1st January 1933 and the sources from which they were derived were as follows:

	R. million
Long-term deposits of co-operative associations	393·6
Special deposits by various organisations	654·3
Budgetary grants	45·7

Measures are being taken to concentrate all co-operative funds in the Vsekokbank under two categories, according to whether the deposits retain their identity and are repayable to the depositor or as non-reclaimable contributions go into a general pool. A distinction must also be made between funds whose employment is restricted or unrestricted. The greater part of the funds distributed by the Vsekokbank consists of the profits, savings and other means of the co-operative system concentrated and mobilised in the bank, and the greater part of the advances made are in the form of repayable interest-bearing loans.

§ 4. THE AGRICULTURAL BANK

The Agricultural Bank (Selhosbank¹) may be said to have been established in 1929 under the title of Central Agricultural Collective Bank. Its functions then were rather those of a short-term credit bank than of the more exclusively long-term credit institution which it afterwards became. In connection with the general credit reforms of 1930 it was renamed the All Union Collective Bank and became practically a department of the Gosbank. In 1932, with the increasing need for capital investment in developing collective agriculture, the Gosbank formed a bank for financing socialised agriculture, to which was entrusted the duty of financing the capital needs of agriculture from state and collective farm funds. This bank still worked in close liaison with the Gosbank. In 1933 the bank was re-organised under the name of the Agricultural Bank and became an independent long-term credit institution. The bank as now organised has 50 offices. 207

¹ *Selkhozpromstroy Bank.*

interregional and 242 regional branches and 386 inspectorial groups. The distinction between the interregional and regional branches is purely a matter of the areas in which they operate.

The inspectorial groups are attached to branches of the Gosbank in districts where the Selhozbank is otherwise unrepresented, and their duty is to check and authorise all payments by the Gosbank on behalf of the Selhozbank. Chief inspectors are appointed by the leading provincial or regional branch of the bank and confirmed by the provincial or regional executive committee. They are thus independent of the district organisation and are responsible for the correct execution of the finance and credit programme of agricultural capital investment in their territories. In districts where the Selhozbank is not represented by a branch or inspector, the local branch of the Gosbank acts as its agent, and all cash transactions, both the receipt and payment of money, are carried out by the branch, which must in addition see that all payments are properly authorised, are not in excess of the plan and that prices of material correspond with the current official price-lists, etc. It is also provided that in districts where there is no agricultural branch bank, but where there happens to be a branch of one of the other long-term banks, the latter may by arrangement act as agent for the Selhozbank. The converse may similarly be arranged.

Agricultural long-term finance is divided into two sections: the first consists of non-repayable grants to state agricultural enterprises, including state combines and trusts, Machine-Tractor Stations and District Administrations of tractor centres under the Commissariat of Agriculture; the second of long-term produc-

tive credits to collective farms, communes, agricultural cartels and associations of collective farms, as well as in certain circumstances to individual collectivised and independent farmers. The funds reserved for each class of finance are derived from different sources.

Non-repayable advances are made from funds originating from grants from the national and republican budgets and levies—percentages of profits, amortisation reserves, etc.—on state agricultural organisations.

The funds for repayable loans are derived from the foundation capital of the bank, its reserves and special funds; from the free balances of constructional organisations deposited on current account with the Selhosbank, the liquid resources of collective farms earmarked for capital development (the so-called indivisible funds),¹ and the free balances of other funds on deposit with the bank. The free balances of indivisible funds concentrated in the Selhosbank are devoted to financing new construction, capital repairs of buildings, the purchase of live-stock and chemical fertilisers, the acquiring or capital repair of machinery and implements, planting permanent crops and so on.

The bank pays interest at the rate of 6½ per cent per annum on the credit balances of all collective farm funds. Interest at 2 per cent per annum is paid on the deposits of state organs and 1½ per cent on contributions to the fund for cultural and dwelling-house construction.

¹ The "Indivisible" fund of a collective farm consists of an appropriation of 10 to 15 per cent of its gross revenue, the contributions (or entrance fees) of new members, the proceeds of the sale of surplus property, insurance indemnities and the voluntary contributions of individual members to the capital funds. The accumulation of these indivisible funds is the most important source of the bank's loan resources.

The distribution of long-term investment funds to state agricultural enterprises is carried out according to a yearly and quarterly plan in much the same way as to state industry. The plan not only lays down the amount to be granted to each combine and trust but also the proportion to be used for financing new building, capital repairs, the purchase of new machinery, draught cattle and live-stock generally, etc. Within limits and with the approval of higher authority, the combines and trusts have a certain measure of freedom in apportioning their total grants among their various individual enterprises.

The long-term loans granted to collective farms are also governed by the plan drawn up in principle by the Commissariat of Agriculture in consultation with the Selhozbank and reduced to a more detailed form by the various republican, provincial and regional Commissariats, the final distribution to individual farms being precisely determined by the District Agricultural Administrations in consultation with the inspectorial groups. Credit to collective farms is granted under 20 heads; of these 7 concern live-stock breeding, 5 various crops, and 1 each silk production, bee-keeping, machinery, working live-stock, colonisation, chemical fertilisers, crops for seed-breeding and labour organisation. But before any credit to an individual farm is finally and definitely authorised, the local branch of the Selhozbank makes a thorough investigation of the farm's finances and accounts in order to see that it has properly accounted for all sums received for the sale of produce, etc., has set aside the proper percentage of its gross revenue for the indivisible fund, and has kept proper accounts of the earnings of the individual members. The conditions and terms

of the loan are finally fixed by negotiation between the farm and the bank. The agreement between the two parties, in addition to fixing the terms of the loan, lays down precisely on what object the loan money is to be expended, prices to be paid and the proportion of the whole expenditure to be covered by the farm's own resources. In the event of a loan not being repaid at maturity, a penalty or fine of 50 per cent of the interest rate is imposed. Thus after maturity the outstanding balance of a 4 per cent loan would carry 6 per cent interest.

CHAPTER XI

THE BUDGET

THE budget has of necessity developed along lines parallel with the development of monetary and credit ideas and policies. Four distinct stages are apparent, corresponding more or less to the War Communism, restoration, preliminary reconstruction and full-blooded planning periods in money and credit. The first period, 1918 to 1921, saw the destruction of the former financial system of the country and the introduction of revolutionary forms of taxation, mainly of a confiscatory nature. Estimates of revenue and expenditure continued to be drawn up, but in view of the rapid deterioration of the rouble the figures were meaningless, as is apparent from the following:

	Expenditure	Revenue	Deficit
	R. milliard	R. milliard	R. milliard
1918	46.7	15.6	31.1
1919	215.4	49.0	166.4
1920	1,215.2	159.6	1,055.6
1921	24,471.9	4,139.8	20,332.1

In 1921 the collection of taxes in money was discontinued and the estimates were never even formally passed by the Government.

The beginning of the second period corresponded with the introduction of N.E.P. and the new Chervonetz currency, and in 1922 money taxes again

played an important part, though the budget was still based to a considerable extent on taxation in kind. Out of a total revenue of R.795 million, revenue in kind amounted to R.430 million. In spite of this, there was a monetary deficit of R.265 million, which was covered by the emission of "Sovanaks" (token paper money). It was not till the financial year 1924-25, when the Sovanak had been replaced by the stable Treasury notes, that budget deficits ceased to be covered by the printing press. In order to relieve the strain on the budget, expenditure on industrial and trading enterprises was restricted. This was quite in keeping with the New Economic Policy under which industry was to be reorganized on a purely business footing and meet its own financial needs from its own resources. Though industry made big strides towards recovery during the next three or four years, its development did not satisfy the Soviet leaders, who decided, since voluntary savings appeared insufficient, to reintroduce the practice of financing industrial development out of budget revenue.

The third period began with the financial year 1925-26, when a stable budget for the whole of the U.S.S.R. was drawn up. Between this year and 1930, although the system of taxation underwent many changes in detail, its general structure differed little from the system practised in pre-revolutionary Russia. In consequence of the determination to hasten the development of the country's industrial and natural resources, the budget grew rapidly and at a faster rate than the national income, as is shown by the following table:¹

¹ Birmingham Bureau of Research on Russian Economic Conditions, Memorandum No. 7, October 1932.

	National Income	Budget Revenue	Budget as % of National Income
	R. million	R. million	
1913-	13,896	2,848.9	20.5
1925-26	21,230	4,215.6	19.8
1926-27	22,937	5,626.0	24.5
1927-28	25,342	6,836.1	26.9
1928-29	30,009	8,294.2	27.6
1929-30	33,963	12,986.5	38.2

In 1931 a new system of taxation was introduced. All forms of taxes previously levied (about 70) were replaced by six classes of taxes, three imposed on the "socialised" sector, *i.e.* on enterprises, corporations, etc., and three on private persons.

Taxes on the "socialised" sector were:

- (1) A turnover tax on goods.
- (2) A levy on the profits of state enterprises.
- (3) A tax on the revenue of co-operative enterprises.

Taxes paid by private persons were:

- (1) Income tax.
- (2) Tax on private enterprises and professions.
- (3) A number of small dues, licences, etc., amalgamated into a single state duty.

In addition to the above all peasants, both those farming their own land and members of collective farms, paid a single tax assessed on the quantity of land under cultivation and the live-stock owned by the individual.

The national income and budget revenue for the years 1931-34 were:

	National Income	Budget Revenue	Budget as % of National Income
	R. million	R. million	
1931	40,900	20,342	49.7
1932	45,500	30,574	67.2
1933	48,500	40,153	82.8
1934	55,600 (preliminary result)	53,659 (preliminary result)	96.5

The value of the national income is calculated according to the price-level of the year 1926-27, while budget revenue is given in current paper roubles. Since prices rose considerably between 1926-27 and the years under review, the figures for national income should be increased probably by 15 to 25 per cent to bring the income rouble into line with the budget rouble. But even so, it is plain that the greater part of the gross national income passes directly through the national budget and is redistributed in accordance with the Plan. Since 1932 no price indices have been published by the Soviet Government and it is impossible to compare the cost of living in 1934 with 1930, but it is admitted that retail prices increased very considerably during the period. It is plain that the great industrial development of the country since the first Five-Year Plan began was only made possible by compulsory national saving much in excess of anything that could have been done by voluntary effort.

The Union budget is not the full tale of public expenditure. Each independent republic has its own budget in addition to the local budgets of autonomous bodies. The budget estimates for 1934 were: Union budget, R.48.8 milliard; Republican budgets, R.2.7 milliard; and Local budgets, R.7.7 milliard. Out of the Union budget the sum of R.3.7 milliard was to be

transferred to the Local budgets, and R.8.7 milliard therefore remained to be raised by local taxation, etc. In other words, the population of the country directly or indirectly had to find some R.55.6 milliard to finance public expenditure. The revenue of the republican and local budgets is derived from fixed percentages of the gross amounts of the general turnover tax, of subscriptions to the state loan and of the peasant tax and certain other taxes collected in their territory. These sums are passed through the Union budget. In addition the republican and local governments have the right to impose and collect certain local taxes and to take part of the net profits of local industrial and commercial enterprises; that is, enterprises administered by the local authorities and not under a people's commissariat. Republican and local government expenditure is mainly on education, health, dwelling-house building and other social and cultural needs, but to a fairly important extent also on local economic development, including communal services, industrial enterprises and agriculture.

The Union budget revenue is classified under three heads, viz.:

Revenue from socialised economy.

Mobilisation of the resources of the population.

Sundry.

The first class contains the yield of the turnover tax and other taxes on enterprises and corporations, deductions from the net profits of industrial, commercial, insurance and other socialised enterprises, certain proportions of the revenue of railway, water and other transport and national communications (post, telegraphs and telephones), subscriptions to the state loan

by institutions, enterprises and corporative bodies, excise duties, income tax on socialised undertakings and taxes on state farms. The second class consists of individual subscriptions to the state loan, savings deposits, dues and levies on the individual for the construction of dwelling-house and cultural buildings, income tax and the peasants' tax. In the third group the only item of importance is the contribution from the All Union Central Council of Trade Unions for providing stipends for students.

The budget estimates for 1934 provided for the following revenue:

I. Revenue from Socialised Economy:

	R. millions
Turnover tax	29,228
Special goods fund (i.e. the extra profits from the sale of goods at commercial prices)	6,300
Taxation	525
Deductions from profits of enterprises	1,531
Revenue from transport, etc.	2,937
Loans, excise, taxes	614
Total revenue from Socialised Economy	41,125

II. Mobilisation of the resources of the population:

State Loan subscriptions	3,580
Savings deposits invested in State Loan	300
Taxation	2,646
Total	6,526

III. Other revenues	1,236
Grand total	48,879

Expenditure is classified under seven heads as follows (estimates for 1934):

I. <i>National economy</i>	33,383
(of which the chief items are—	
Heavy industry	11,360
Agriculture	5,880
Trade and supplies	3,921
Railways	3,736
II. <i>Education, health, etc.</i>	3,019
III. <i>Administration and defence</i>	2,873
IV. <i>Loan service</i>	1,702
V. <i>Transferred to local budgets</i>	3,698
VI. <i>Transferred to other financial institutions</i>	1,156
(of which R.1 milliard to the State	
Bank in repayment (it is believed)	
of former advances and to cover	
losses incurred in financing state	
enterprises. The balance consists of	
grants to insurance funds)	
VII. <i>Sundry expenditure</i>	3,048
(to various reserve funds)	
Grand total	<u>48,879</u>

Of the total revenue about 84 per cent was derived from socialised undertakings, leaving only 16 per cent to be paid by the population individually in the form of subscriptions to loans and taxation. Of the total expenditure R.33.4 milliard, or about 68 per cent, was devoted to the financing and development of national economy. Of this sum rather more than half, actually R.17.8 milliard, was earmarked for capital construction, while total capital investment, according to the finance plan, was to amount to R.25.1 milliard. The national capital investment during 1934 was therefore 70 per cent financed by budgetary grants and 30 per cent by the profits of enterprises that did not pass through the budget.

The large proportion of state investment funds allotted to heavy industry, which greatly exceeds the revenue received from heavy industry, is made possible by the complete control by the State of the national savings.

To make a comparison between the Soviet budget and a capitalist state's budget, a rearrangement of the classification of revenue and expenditure is necessary.

REVENUE		
(In R. millions)		
Indirect taxation		36,283
Direct "		3,032
State enterprise		4,458
State borrowing		4,325
Sundries		781
ϕ.		<u>48,879</u>
EXPENDITURE		
(In R. millions)		
<i>Administration—</i>		
Government		1,078
Defence		1,795
Education		2,669
Health		238
Insurance, etc.		268
		<u>6,048</u>
<i>State enterprise—</i>		
Industry		15,595
Agriculture		5,880
Transport		8,894

Brought forward	39,431
<i>Loan service—</i>	
State loan	1,702
Repayment of debt to State Bank	1,000
	2,702
<i>Grants to autonomous budgets</i>	3,698
<i>Sundry funds</i>	1,477
<i>Surplus (to reserve)</i>	1,571
	<u>48,879</u>

When the Soviet budget is analysed and rearranged as above, the outstanding features are the amount of revenue collected through the medium of indirect taxation and the large sums applied to the financing of national economy. Nearly five-sixths of the total sum received from indirect taxation is on account of the turnover tax, which ranges from about 5 to 80 per cent according to the relative essential or luxury nature of the goods. The revenue received from state enterprise is surprisingly small considering that the value of industrial production alone was R.46.8 milliard in 1933.

The sum (R.1.5 milliard) passed to the budget on account of the state's dividend from industrial profits, however, was only a comparatively small portion of total industrial profits, which for 1934 were estimated at R.7 milliard. The difference is retained by the industries for general purposes, largely for capital investment, and only an insignificant fraction is devoted to consumption such as premiums and bonuses to employes and workers or improving the material and cultural well-being of the workers.

At the beginning of 1934 the total internal indebtedness of the Soviet Government amounted to about R.13 milliard and the service of state loans in 1934 to

about R.1.7 milliard; of this, however, only some R.835 million was paid out in interest, premiums and amortisation to private individuals, the balance being due to collective bondholders, state enterprises, institutions and co-operatives, who would use the money for increasing their capital and not for current consumption. During the six years 1928-34 total capital investments amounted to over R.90 milliard, so that state borrowing has not played a very important part in capital investment, the bulk of which has been provided by compulsory saving; in other words, by restricting the consumption of the population.

CHAPTER XII

THE DISTRIBUTIVE SYSTEM

§ 1. RETAIL TRADE

THE wholesale exchange of raw materials, partly manufactured and finished goods between state industrial enterprises is regulated by the Plan and is effected normally under a system of contracts between the producing and consuming enterprise or trust.

The supply and distribution of consumption goods to the population is also regulated by the Plan, but there are various intermediate organisations through whose hands goods pass *en route* from factory to consumer. Every trust or group of trusts is linked with a commercial organisation, known as a syndicate,¹ which carries out all the purchasing of raw material, consumption goods, etc., and the selling of the trusts' finished output. The selling department of the syndicate, known as "Sbyt" (from *sbyvat*, to market), takes over the finished output of the factories at the controlled prices, with the exception of that proportion of the goods taken directly by state consuming institutions, such as the Red Army. The Sbyt is the last link in the productive system from which goods pass into the distributive system.

¹ Though the name is the same, these syndicates are not the same thing as those originally established in 1922. The present syndicates are purely commercial organisations without any administrative functions.

The retail distribution of consumption goods is effected through three channels:

The Co-operative System;
The State Trading Organisations; and
The Factory Supply Organisations.

In addition there is the free market on which the peasants and collective farms dispose of surplus produce direct to the consumer.

Each of the above three systems has wholesale purchasing organisations which buy their assorted requirements from the various Sbyty. The Sbyt, of course, only stocks and sells one class of goods, be it textiles, footwear, pottery, etc., while the co-operative and other wholesale purchasing organisations hold stocks of every kind of consumable article. As a general rule it may be taken that the retail shops draw their requirements direct from their respective wholesale organisations, but there are two important exceptions. The so-called commercial shops in the big cities with an annual turnover running into millions of roubles, though belonging to the state trading system, are privileged to deal direct with the Sbyty, while the small village shops are grouped together under so-called "regional bases" forming a sort of semi-wholesale link between them and the central wholesale organisations.

Formerly the co-operative system was the source of supply for all the agricultural population and a large section of the urban proletariat. In 1932, however, the state distributing system was greatly increased, expanding its turnover by 100 per cent over 1931, and in 1934 it accounted for about 60 per cent of the total retail turnover. The reason for relegating the

co-operative system to a subordinate position was largely the inefficiency of the system, especially in the country, where the small village co-operative shops entirely failed to supply the peasants' wants. In September 1935 the country co-operative system was reorganised. Several thousand new department stores were to be established in market towns and large villages, and many of the small village shops were ordered to be closed or several to be amalgamated into a large shop. While the new stores and shops were still nominally to belong to the co-operative system, the authority of the central organ, or *Centrosoyus*, over them was severely circumscribed. In actual fact, by the end of 1935 the co-operative system had lost so much of its original independence that in many ways it had become a state organisation in all but name.

By the close of 1935 the rationed distribution of everyday consumption goods had practically been abolished. The following description of the state retail distributive system therefore applies to conditions prevailing before 1935, when there was a sharp distinction between the "closed" shops which sold rationed goods and the "commercial" shops where demand was restrained only by price. An important section of the state retail system consisted of the shops to which the higher government officials and the officials and senior employés of state institutions, such as the banks, were attached, and the so-called "Insnab"¹ shops for the use of the foreign employés of the Soviet Government. The state shops for officials, known as G.O.R.T.,² were subdivided into two categories, A and B. The former, whose members had the privilege of purchasing a

¹ *Insnab*, derived from *Inostrannoe Snabzhenie* = Foreign Supply.

² State Department of Retail Trade.

greater variety and greater quantities of goods at fixed government prices than in any other class of shop, were confined to the highest state officials and Party leaders. The B shops, at which the ration, though inferior to A, was still relatively generous, were open to persons holding important and responsible posts in the government and state institutions, but not necessarily members of the Party. The Insab shops supplied a fairly generous ration, at least equal to the G.O.R.T. B shops, to the foreign engineers, technical workers, etc., directly employed by the State or state institutions from whom they received ration cards. To some extent the privilege of buying at Insab shops compensated the foreign worker for the loss of the right to receive part of his salary in foreign money.

The Factory Supply Organisations, or O.R.S.,¹ also formed part of the state system. Every large industrial unit employing over a given number of hands had its own private retail shop or shops for the exclusive use of the employes and workers. These were managed by the deputy managing director of the enterprise, and goods were obtained from the purchasing department of the syndicate of the trust to which the enterprise belonged.

In 1931 the so-called "commercial" shops made their appearance. These shops sold all manner of food-stuffs and manufactured goods without restriction but at prices many times higher than the ration price. Commercial trading rapidly increased until in 1934 it accounted for about 25 per cent of the total value of the retail turnover throughout the country.

On 1st January 1935 the sale of all bread, cereals and fodder was entirely derationed. A single price level,

¹ Organisation for Workers' Supply.

varying, however, in different parts of the country, was fixed for these commodities, which henceforth were sold to all comers from the shops of the state and co-operative system formerly supplying them and from new shops established specially for the distribution of these goods. On 1st October 1935 meat, fish, sugar, butter and vegetable oils were derationed. While the new prices for all derationed goods were fixed by the Government, they had to be at a level which would bring supply and demand into equilibrium. On the average the derationed or market prices were about midway between the former ration and commercial prices. This meant a rise of from about 50 to 100 per cent over the former ration price.

Finally, mention must be made of the "Torgsin" shops, which, however, came under the Commissariat of External Trade and not under the Commissariat of Internal Trade. The word "Torgsin" is the equivalent, broadly, of "Trade with Foreigners". At these shops, goods, generally of better quality and in greater variety than at other shops, were sold for gold roubles. That is for gold, silver or foreign currencies, paper roubles not being accepted. Prices were marked in roubles, payment being made in foreign currency at the official rate of exchange or in precious metals according to the nominal gold content of the rouble. The gold-rouble price in Torgsin shops had no fixed relation to paper-rouble prices in other shops, but in 1935 the average rate for a number of common articles was such that about one gold rouble equalled twenty paper roubles. On 1st February 1936 the Torgsin system was terminated, and all its shops were transferred to the Commissariat of Internal Trade for the sale of goods at ordinary rouble prices.

[Since the above was written certain changes in the organisation of retail trade have been introduced.]

From the beginning of 1936 retail distribution generally was freed from restrictions; henceforward no member of the community could possess the privilege of buying more of anything or at cheaper prices than his fellows. Differences in remuneration between skilled shock-workers and ordinary labourers depended exclusively on their respective money wages.

Rationing inevitably required a considerable degree of centralised control; its abolition made decentralisation possible and desirable. Consequently the Commissariat of Internal Trade was able to divest itself of much detailed administrative work, and devote itself more to planning, finance, transport and wholesale distribution, leaving to local organisations the duties of organising retail shops and supplying them with goods. Since all shops now sold goods to all comers at universal prices the former distinctions between closed and commercial and between co-operative and state shops disappeared.]

§ 2. THE COLLECTION AND DISTRIBUTION OF AGRICULTURAL PRODUCE

Agricultural produce supplies the raw material of certain industries, such as textiles, sugar refining and tobacco, as well as foodstuffs, such as grain, vegetables and fruit. The system of collecting from the producer and distributing to the consumer differs in only minor respects between the two classes of produce. The organisations responsible for the so-called centralised collection of all forms of produce are government departments under the Council of Peoples' Commissars. They take delivery and pay for the produce delivered by the farms and are responsible for the further storage and transport of the produce, the grain-collecting

organs, for instance, owning elevators. In some cases, for example cotton, the produce after collection is subject to preliminary processes, such as cleaning, sorting and baling. The collecting organisations deliver industrial raw material direct to the consuming industrial enterprises; grain is mainly delivered to the milling trusts, but the quantities earmarked for export are taken over by the State Grain-exporting Department. Perishable foodstuffs are delivered direct to the various state and co-operative retail organisations, one of the most important being the State Restaurant Trust which runs all the public eating-places within the Union.

The most important exception to the above system is sugar. For obvious technical reasons it is preferable to maintain sugar refineries in the closest proximity to the crops and to have the raw beetroot delivered direct to the factory. There is thus no need for an intermediate collecting organisation.

A considerable proportion of foodstuffs reaches the consumer through what is known as the decentralised collecting system. The collective and individual farmers are compelled to deliver to the State at extremely low prices a large portion of their gross harvest of grain and other food crops as well as fixed quotas of milk, meat, etc. After fulfilling the statutory deliveries and making due provision for seed stocks and his own requirements the peasant may sell any remaining surplus on the free market. A certain amount of the free surplus of perishables—fruit, vegetables, eggs, etc.—is sold direct to the individual consumer at specially authorised markets in the towns. Most if not all of the surplus grain and a large portion of other foodstuffs, however, are bought by the co-operative and state trading organ-

isations direct from the growers at prices considerably above those paid for compulsory deliveries, but still confined to certain limits through state action. Primarily the state collections are earmarked for the consumption of state institutions, the army, fleet, etc., and for export. The remainder is insufficient fully to satisfy the needs of the urban population and industrial workers, and therefore the decentralised collections play an important part in the general supply of foodstuffs. This, however, does not constitute a free market in the full sense, for maximum prices are fixed by so-called "Convention Bureaus".

§ 3. TRANSPORT

Transport and Communications come under three People's Commissariats, viz.:

Land Transport.

Water Transport.

Communications (posts, telegraphs, telephones).

There is also a government department for road transport and road construction. This is classed as a Central Administration, but has almost the status of a People's Commissariat.

The railway system consists of 27 separate lines each under an independent Administration.

Shipping is divided into 23 river and 6 sea shipping companies.¹

The Commissariat of Communications has no similar subordinate divisions.

Each railway company possesses its own shops for

¹ Since this was written there have been certain amalgamations of shipping authorities.

running repairs, but major or so-called capital repairs are carried out by an independent organisation directly under and responsible to the People's Commissariat.

Financially the whole railway system forms a single unit. All traffic receipts are paid into a common pool out of which each company is repaid its theoretical working costs, calculated according to the turnover and average cost of the traffic handled. Receipts are pooled because, while freight and passenger rates are standardised for the whole Union, each railway necessarily has its own predominating class of freight (grain, timber, coal, etc.) according to the region it serves. The cost of maintenance also varies according to locality.

River shipping is organised on a basis of individual rivers. As a general rule one shipping company manages all the traffic on a single river, the capital repair shops as in the case of the railways being independent concerns. In point of organisation the Volga, the most important water-way in the Union, presents an exception. The shipping on the Volga is under three separate companies for the Upper, Middle and Lower reaches respectively. But while the three companies are responsible for the organisation and general conduct of traffic within their own areas only, their respective fleets consist respectively of fast passenger ships, slow "Post" mixed passenger and freight ships, and purely cargo vessels. Thus each company's ships traverse the whole river, but each company's jurisdiction is limited to its own stretch of the river.

PART III

CHAPTER XIII

A PLANNED CURRENCY

SOVIET economists have never produced a concise definition of money, but they have more or less clearly enumerated those functions which it should have and those which it should not have in a socialist economy. Stripped of a good deal of superfluous verbiage, they hold that money should not be a commodity in itself. That is to say, it is not a marketable commodity in the same sense as it is in a capitalist society. It cannot be employed for the accumulation of capital by an individual; in other words, no private individual by amassing money can convert it into reproductive capital. Primarily money is a means of expressing the amount of labour employed in the production of goods by socialised enterprise, and thus it serves as the counterpart of the goods themselves. Money therefore is a unit of account by means of which the realisation of the Plan of production and distribution can be controlled and checked. Money also supplies a medium for settling debts and paying wages. The receipt of money gives the holder a certain claim on the State, but this is not an unconditional claim. The State obviously can honour its bonds, that is the money in possession of the corporations and private citizens, to what extent and in what manner it pleases, because trade is a monopoly of the State. But until complete communism is achieved

there will always be a certain amount of buying and selling outside the state trade monopoly. Peasants sell their surplus produce to the urban housewife in the town markets; the higher paid officials employ domestic servants; a few doctors and dentists have a small and more or less clandestine private practice; small artels, that is a co-operative association of perhaps eight to a dozen members, undertake such services as boot repairing, tailoring, household repairs and so on. In order that these classes shall receive payment for their goods or services the purchasers must possess some form of transferable medium, *i.e.* money, which can be delivered to the seller. In a state of complete communism there will be no private enterprise of any description, but it is recognised that during the intermediate stage of socialism such forms of private enterprise are either indispensable or at least satisfy a demand which the State is as yet unable to satisfy and must therefore tolerate.

In a fully communist society every individual stands in direct and equal relation to the community, all labour is performed for the community and all supplies are drawn from the community's stocks; thus money is unnecessary, and would in fact seem to be incompatible. But in the existing Soviet system there is and will continue to be for an indefinite time a large section of the population which does not exist in such direct affinity with the State as the industrial workers and other employés of state enterprises and institutions.

Soviet economists and political leaders, in defending the retention of money against the Left Wing communists who advocate its abolition, always say that the Soviet Government adopted money from the

capitalists only to use it as a weapon against capitalism. Only in so far as Soviet money has been rendered useless as a means of accumulating capital or as a market standard, can it logically be regarded as an instrument for the confusion of private enterprise. Even these deficiencies are not due to any change brought about in the subjective nature of money, but to the peculiar conditions in which Soviet money operates. Money can only exercise its full and complete functions when it forms a medium of exchange between two or more independent and disassociated parties. In the Soviet system there can be no free bargaining, because planning as the foundation of all economic activities has been substituted for the capitalist system of private enterprise and open markets. Planning is the attempt to concentrate in the hands of the Government the whole power of deciding a comprehensive programme of production, distribution and consumption, aiming at an accurate and continuous direction of production to authoritatively determined consumption and the elimination of the periodic fluctuations inherent in capitalist economy.

Planning can be complete only when the State owns or entirely controls all means of production and distribution. This condition has effectually been reached in the Soviet Union. Industry as a whole may be compared to a gigantic combine in which the individual industries and individual enterprises have a considerable measure of independence, but are controlled by a central organisation which determines all matters of major policy. Agriculture, though divided into state farms, collective farms and individual peasant holdings, is directly subject to the Central Government's agricultural plan. The distributive organisations in-

clude state and co-operative trading enterprises and the comparatively small open market. But quantitative and qualitative distribution as well as prices are, within narrow limits, determined by the central planning and price-fixing authorities.

Broadly speaking, the rouble fulfils three different functions. Firstly, it serves as a purchasing medium in retail trade in much the same way as any other money. Secondly, the rouble serves as a unit of account between enterprises and in wholesale trade, and in this connection the note circulation plays practically no part, accounting being almost exclusively a matter of book entries. The distribution of wholesale commodities both in industry and trade is planned. The Plan lays down what proportion of the national production shall be devoted to consumption and capital investment respectively, and the rouble merely serves as a common denominator in which the Plan can conveniently be expressed. Thirdly, the rouble provides a medium in which costing accounts may be kept. Its function in this province is essentially to control production and operating costs, for it makes possible a comparison between the relation of consumption or expenditure to production in various undertakings.

Except in retail trade the rouble appears more as an instrument of planning than as a measure of value. In itself it possesses no absolute value or unconditional purchasing power, for all the means of production and distribution belong to the State, and therefore an open commodity market such as exists in the capitalist world is eliminated. In such circumstances the formation of prices and their reaction on the national economy show many differences from the capitalist system. In all economic systems money as a tangible

thing is inseparable from the abstract idea of price, and prices are at the root of the economics of any society except perhaps one based on barter. It is therefore reasonable first to examine the nature of prices in the Soviet Union as a foundation for the further study of the significance and rôle of savings, the budget, credit, costs, the banking system, etc., in the Soviet monetary system.

CHAPTER XIV

PRICES

§ 1. THE ROUBLE IS A PURELY INTERNAL CURRENCY

IN the days before the War when all the important currencies of the world were on an effective gold standard, a unit by weight of gold possessed on the whole much the same purchasing power in all civilised countries. Differences in the price-levels of staple goods, for instance, textiles and foodstuffs, were caused by import duties, transport costs, etc. Thus in the Russia of those days most manufactured articles cost more in terms of gold than similar articles cost in Great Britain, but the price of food was considerably less. Since the War exchange control, trade restrictions, the devaluation of some currencies and the entire suspension of the gold standard in others have brought about much wider divergencies between the internal price-levels of different countries in terms of gold, though the natural tendency, checked though it be by government interference, to import from abroad goods that are cheaper than the home production and to export home-produced goods for which a better price can be obtained abroad, has prevented fantastic differences in the purchasing power of gold. Even in those States in which currency control has reached its apotheosis there remains a vestige of an exchange market which has some equalising effect. Since the majority of the population in any country has a difficulty in visualising the

proportions of a sum of money expressed in any unit but their own, the popular press usually converts foreign money into terms of the local unit. And when an English newspaper reports, say, that the French Government has spent £14,000 on some object when the actual figure was a million francs, or in the same way denotes a million reichsmarks by about £80,000, the reader is given a fairly good idea of the significance of the sum. Since the complete break between the rouble and foreign currencies (about 1926) the internal purchasing power of the rouble has steadily diverged from world gold prices, and to-day it is merely fatuous to try to symbolise the value of the paper rouble in terms of any other currency.

§ 2. COMPARATIVE VALUE OF THE ROUBLE

The Soviet Government draws up its budget in paper roubles and calculates the value of its investments in industrial enterprises in the same unit. In 1935 the budget estimates for defence amounted to R.65 milliard. This at the State Bank's official quotation was equivalent to about £1200 million. But to say, as some newspapers did, that the Bolsheviki were spending £1200 million on their fighting services, is entirely misleading. The only way of comparing expenditure in roubles with expenditure in a capitalist currency is by calculating, if possible, an equivalent purchasing power. But the whole theory and conception and even the functions of prices in the Soviet economy are so different from all capitalist notions that the task is virtually hopeless. It is of course possible to compare the prices of certain standard articles, and these show that the purchasing power of the rouble is very much

less than the purchasing power of the nominal gold equivalent in any other country. Wheat, cotton and pig-iron are three typical staple commodities representing food, consumption industry and heavy industry which may be used as examples.

Wheat.—A decree was issued by the Government dated 25th August 1933, fixing the wholesale price of wheat sold for consumption as food at R.25.75 per 100 kilo for soft, and R.27.75 per 100 kilo for hard sorts, an average price of R.26.75 per 100 kilo or R.12.16 per 100 lb. At the theoretical gold parity of about R.9.5=£1 R.12.16 is equivalent to about £1 : 5 : 7, or more than five times the average price for Russian wheat at Liverpool at about the same period. The wholesale price of wheat in Russia has risen in the meantime.

Cotton.—According to a decree of 7th March 1935 the prices to be paid by the State for the raw cotton delivered by the peasants in Central Asia, the Caucasus and South Russia ranged between R.1150 and R.1700 per ton according to circumstances. This works out at an average price of about R.1400 per ton, or approximately 64 kopecks, or 1s. 4d. per lb. At the same time Liverpool quotations were roughly 6d. per lb. for American cotton and 8d. per lb. for Egyptian.

Pig Iron.—According to the paper *Ekonomicheskaya Zhizn* of 20th March 1935 the cost of producing a ton of pig-iron in 1934 at the Kirov metallurgical works at Makeevka, Central Russia, was R.60.56. Since this was hailed as an achievement, the cost was presumably below the average for all ironworks in Russia. The equivalent of R.60.56 at nominal gold parity is £6 : 7 : 6, while according to the *Statist* the average price of pig-iron in the United Kingdom in March 1935

was 68s. 8d. It should be noted that the rouble figure mentioned referred to production costs and that the wholesale selling price would presumably have been greater.

These particular prices, which may be taken as fairly representative, indicate that rouble prices have no relation to world prices and that they are really worthless for the purpose of arriving at an index for a comparison between the rouble and capitalist currencies.

§ 3. BASIC PRICES

In the Soviet Union prices are fixed by the Government in accordance with its politico-economic policy, though it has proved impossible in practice to suppress the influence of supply and demand. Broadly speaking, the Government's price policy may be divided into three parts: (1) prices paid to the agricultural population for foodstuffs and raw material, (2) wholesale industrial prices at which the products of industry change hands, (3) retail prices at which consumption goods are distributed to the population. Since the State owns or controls practically all the means of distribution, the Government in effect acts as the middleman between the peasant producer and the proletarian consumer and, like all middlemen, is concerned to buy cheap and sell dear. On account of its monopoly in trade it is in the position to fix its buying and selling prices at any level it likes. In the case of trade between state enterprises the Government obviously gets no advantage from trading profits, and therefore prices mainly serve as symbols facilitating the keeping of accounts and statistics.

Agricultural produce is obtained by the State

(1) through compulsory deliveries at fixed prices, (2) by centralised and decentralised purchases at conventional prices, and (3) by payment in kind by the collective farms for the use of agricultural machinery supplied by the state Machine-Tractor Stations.

Under the system of compulsory deliveries the collective farms and individual peasants are bound to deliver to the State a definite quantity of produce at fixed prices. The prices paid for these deliveries are very low in comparison with the price-level for industrial goods. The difference between the prices actually paid and what would in the circumstances be a fair price may be regarded in the light either of taxation or as rent for the land or possibly as combining the characters of both. There are, moreover, no fixed standard prices for the whole country, but irrespective of quality higher prices are paid in some regions than in others. The differences are arbitrary and depend on the Government's policy of favouring certain regions for political or economic reasons.

The collective and individual peasants are in theory permitted to dispose as they like of surplus produce after fulfilling their compulsory obligations to the State. A certain quantity of foodstuffs is sold direct to the city consumers at regular market-places in the towns, but the greater part of the surplus, particularly of grain and non-perishable produce, is sold either to the state collecting organisations or to individual state enterprises at so-called conventional prices. Purchases made by the state collecting organisations are termed "centralised", while "decentralised" purchases, are those made by individual enterprises, such as industrial factories, for their own consumption. The prices paid, however, are the same and are fixed by the conven-

tional price-fixing bureaux, whose duty is, in practice, to see that the maximum limit laid down by the Central Government is not exceeded. As a rule the conventional prices are somewhere between 20 and 40 per cent above the compulsory delivery prices. But even this is much below the price-level that would result from the free play of competition, for a perpetual watch has to be maintained to see that rival purchasers do not bid against one another.

Farms whose ploughing, sowing, harvesting, etc., is done by the tractors and machinery of the Machine-Tractor Stations hand over as payment for these services a certain percentage of the realised crop. The actual produce, except such quantities of foodstuffs as the Machine-Tractor Stations require for their own consumption, is taken over by the state collecting organisations and the value is credited to the bank account of the Machine-Tractor Station.

From this it will be seen that there is no question of market prices for primary commodities. The State obtains the food supplies for the industrial and urban population and agricultural raw material for industry at arbitrary prices, which in practice are fixed roughly at the minimum cost of production or may perhaps be better described as prices which give the producers the means of purchasing the minimum quantity of industrial goods needed both for their own consumption and for the proper cultivation of their land. The implications of this price control are far-reaching. The production costs of manufactured goods are determined partly by the cost of the raw material and partly by the cost of labour. Other factors, such as interest rates and rent, which play an important part in capitalist economy can be ignored, for even if they

exist at all in Soviet conditions their nature and significance are quite different. If the cost of raw material depends on the arbitrary prices fixed by the Government, wages, at least for the rank and file labour, are almost equally determined by the cost of food, which again depends on the arbitrary prices paid to the producers. It is possible to go even further and show that the price paid for raw material such as cotton, flax, etc., must be largely dependent on the price paid for bread grains, for the prices paid by the State to the cotton-growers are calculated with reference to the prices the latter must pay for their own food supplies obtained from the State. Since in Russia bread is by far the most important constituent of human diet, far more so than in any Western industrial State, it would seem to follow that all prices in the Soviet Union must ultimately be founded on the price of grain. Unfortunately, however, the price of grain is useless as a standard measure for the purpose of making any comparative analysis of Soviet prices because of the distortion caused by the Government's policy of manipulating the retail prices of all commodities and manufactured goods and by the inclusion of turnover and other taxes.

§ 4. ACCOUNTING PRICES

While the price paid by the State for the deliveries of agricultural produce is paid in money, that is to say while the producers receive a certain sum in roubles which gives them a purchasing power over goods and commodities supplied by the State, the prices of wholesale manufactured goods can only be regarded as an accounting value. Wholesale industrial prices are deter-

mined by production costs, that is the price paid by the manufacturing enterprise for the raw material together with the expenses of manufacture to which is added general overhead charges and a fixed percentage to cover planned profits and amortisation. There is nothing in this showing any important divergence from capitalist practice except that wholesale prices are planned or fixed on the basis of average costs in the whole of the individual industry. Consequently by no means every factory or enterprise works at a profit, though aggregate profits within an industry itself, if not within each trust or combine, generally more than cover aggregate losses. This system allows uneconomic enterprises to continue operating at a loss, which in conditions of competitive capitalism would disappear if they could not improve their methods and reduce costs. But in Soviet economy the connection between prices and profit-making is not the same thing as in capitalist economy. The function of prices in Soviet industry is mainly to afford a costing unit for the control of waste and for comparing the relative efficiency of individual enterprises in the same industry. In a purely capitalist system a private manufacturing enterprise which, from any cause, is unable to produce at competitive prices, must sooner or later go out of business, but a Soviet enterprise which, owing to obsolete plant, unfavourable situation or other reason, cannot produce at the planned price can be, and normally is, kept alive by means of subsidies.

§ 5. THE FORMATION OF RETAIL PRICES

Wholesale prices, which, as has been explained, fairly closely reflect the actual production "cost" of

industrial goods, govern the exchange of wholly or partly manufactured goods between state enterprises, including the wholesale organisations of retail trade. But the price paid by the last named normally includes the turnover tax, which is imposed on nearly all articles and which varies enormously according to whether it is the policy of the Government to encourage or restrict the consumption of any particular article. The principle that demand will sooner or later be followed by supply until equilibrium is reached at a price which provides just sufficient inducement to produce finds no place in Soviet economy. At normal prices, that is, the wholesale price plus a reasonable addition to cover distribution costs and profits, the demand for every kind of consumption goods would be far greater than the supply. To adjust demand to supply two expedients are used, namely, rationing or restricting distribution regardless of price, or increasing the price until equilibrium is reached. By limiting purchasing power through reducing wages and salaries total effective demand could theoretically be adjusted to supply, but this would not fit in with the principle of planning, which not only aims at fixing total consumption but at determining the relative consumption of different classes of commodities and ensuring the planned addition to capital.

As a result of planning, or rather as an important part of the mechanism of planning, there are several distinct retail price systems in operation:¹

¹ At the end of 1935 rationing was abandoned as a means of controlling the distribution of consumption goods. Instead the principle of restricting demand by the operation of price was adopted. The multiple price system was one of the most interesting developments of Soviet economy and I have therefore not altered this description. The results and implications of derationing are discussed in the final chapter.

(1) Normal (*i.e.* ration) town prices at which limited quantities of goods are sold to that part of the population possessing ration cards.

(2) Country prices at which the peasants buy manufactured goods at village co-operative shops. For most articles the price is about equal to the town "commercial" price (see below), but at the same time some form of ration limit is imposed. This is necessary because the amount of industrial consumption goods allotted to the rural population is per capita much less than the amount which the more privileged industrial proletariat is permitted to obtain, and consequently supply even at the higher "commercial" price does not always equal the demand.

(3) "Commercial" prices at which unrestricted amounts of all consumption goods, except bread and cereals, are sold by the state "commercial" shops in the towns. The "commercial" price-level is several times as high as the "normal".¹

(4) Conventional prices at which the peasants sell their surplus produce to the state collecting organisations and to enterprises.

(5) Open-market prices at which the town consumer buys produce direct from the peasants. These prices are determined by supply and demand, though Government action prevents prices rising to an exorbitant level. The most effective check on open-market prices is the prices at which the state "commercial" shops sell similar goods.

(6) The single bread price. Since the abolition of

¹ There was never a constant ratio between "commercial" and "normal" prices. Since the former were determined by supply and demand the "commercial" prices of deficiency goods were proportionately much higher than the commercial prices of relatively abundant goods.

bread cards on 1st January 1935, bread, flour and other cereal foods and fodder have been sold by the State at prices roughly midway between the former rationed and "commercial" prices.

(7) Torgsin or "gold" rouble prices which apply to the Torgsin shops. This is classed as external trade and has no bearing on paper rouble prices.

It is clear that the purchasing power of a given sum of roubles is not constant, but depends on the privileged position of the individual. A worker in a high ration category can obtain either a greater quantity of goods for the same expenditure or the same quantity at a less expenditure than a less favoured individual. To a certain extent, also, the purchasing power of the rouble varies according to locality, for though bread and cereals are now sold without restriction at a single fixed price, this fixed price varies in different territorial "zones", the maximum difference amounting to about 60 per cent. In addition the prices of many essential consumption commodities are lower in the Far North and certain other inhospitable regions as compensation for the rigours of existence, though the cost of transport would naturally tend to increase prices.

Retail price policy, in other words the arbitrary fixing of retail prices, is officially explained as the means whereby the Government controls the relation between national consumption and national saving. It is a feature of Soviet planned economy that saving, or the difference between national production and consumption, is far greater than would be realised were saving left to private initiative. It is this policy of forced saving which makes price-fixing necessary, for in practice the Government decides what proportion of the annual national income shall be saved and

consequently prices must be adjusted accordingly. It is therefore more to the point to say that prices depend on the amount of planned saving than that saving depends on planned price levels.

§ 6. STATE CONTROL OF CONSUMPTION

Prices of goods sold against ration cards are more or less automatically determined by the wholesale price plus turnover tax, plus distributing costs and planned profits. At "normal" prices demand exceeds supply, otherwise rationing would be unnecessary. At one time, when nearly all organised retail trade was rationed, a considerable part of the population's purchasing power was unexpendable and this surplus purchasing medium found its way into the unorganised free market, with the result that peasants who had any foodstuffs to sell obtained fantastic prices. This was not solely because the town population had no other outlet for its surplus roubles except saving, which in the circumstances offered no attraction, but because there was very little inducement for the peasants to amass roubles with which only at rare intervals could they buy manufactured goods. This state of affairs was bad for Bolshevik discipline and brought the rouble into disrepute. Even in state enterprises where the rouble functioned only as a unit of account, book-keeping and costing tended to be perfunctory and inaccurate. Another serious drawback was that the nominal amount of his money wage was of less importance to the worker than his ration category. Also, since as a matter of principle manual labour was rated higher than technical skill, there was no great inducement for the worker to improve his qualifications and become an engineer

or technician, although the salary was more than the wages of a mere factory operative.

A sudden abandoning of the rationing system was manifestly impracticable. In 1931, however, the Government began to establish free retail distribution alongside the ration system, since when a rather rapidly increasing volume of consumption goods has been sold through the "commercial" shops, while the worker's ration has been progressively reduced. Since the beginning of 1935, as already noted, bread and cereal foods have been entirely removed from the ration list and the ration prices of other goods have been raised. At the same time the steady increase in the total production of consumption goods has made it possible to lower "commercial" prices.

"Commercial" prices on the whole must obviously be at a level at which the supply of goods balances the demand, the demand being represented by the purchasing power of the people after buying all they are entitled to at the cheaper normal prices, paying rent, taxes, etc. But to allow prices to be entirely regulated by the free play of supply and demand would conflict with the planning system, and therefore an elaborate price-fixing organisation has been created. There are in all some eleven different price-fixing authorities, ranging from the Union Council of Labour and Defence down to purely local authorities and co-operative unions. The Council of Labour and Defence and a special committee for regulating the supply and distribution of retail consumption goods fix the price limits for representative standard goods from locomotives to bread, while subordinate or local organisations adjust the actual prices for the various descriptions and qualities. The prices of purely local products con-

sumed locally are fixed by local Executive Committees while industrial trusts and combines also have some voice in determining the prices of their own products. But variations in price, except in the local peasant markets, are strictly limited. Standard prices may not be exceeded without permission from the Council of Labour and Defence, it being of course understood that goods of better than standard quality are correspondingly higher priced. Even the conventional prices for farm produce are limited to a certain percentage over the prevailing local price for compulsory deliveries.

Whether the relative authorities fix the actual selling price, or a price to which the turnover tax must be added to arrive at the selling price, is not quite clear. But it is really immaterial. Since the aim of the Government's price policy in retail trade is to control the distribution of the flow of goods, the final selling price is the important thing, and it does not matter whether this is arrived at by adding the amount of the tax to the cost price or whether the difference between cost price and the fixed selling price is called turnover tax.

Since "commercial" trade was introduced nobody within reach of a "commercial" shop has been compelled to save owing to the impossibility of spending money, and therefore "commercial" prices must be high enough to restrict demand to the limits of supply. The Bolshevik leaders at all the various congresses held during the winter of 1934-35 made a great point of the "commercial" prices having been reduced during the past year. At the beginning of 1934 the normal price of bread was about doubled, and though some small increases in wages were given there is no doubt that the urban population generally had to spend a

greater proportion of its income on bread than previously. Consequently there was less money available for other purchases and since, in addition, the supply of industrial goods was all the time increasing, general "commercial" prices could be lowered without demand exceeding supply. The single fixed bread prices introduced on 1st January 1935 meant that a still greater proportion of the worker's income must be spent on food, and it was therefore possible still further to reduce "commercial" prices for other commodities. The more essential any commodity is to existence, the more any variation in its price will affect the demand for less essential things. By increasing the price of bread the Government at the same time automatically reduced the demand for other goods; whereas if it increased the price, say, of musical instruments, the result would be that less balalaikas and accordions would be bought, but the same quantity of bread, etc., would be consumed. It seems a reasonable surmise that one reason for fixing the new bread prices so much higher than the previous average price was to reduce the surplus purchasing power of the people and thereby hasten the day when all rationing could be abandoned.

§ 7. DEMAND REACTS ON PRICES, BUT NOT ON SUPPLY

In the Soviet Union retail trade is synonymous with the State's organisation for distributing consumption goods to the population. There are no independent middlemen. The consumers' co-operatives, which carry out somewhat less than half of the total retail turnover, are economically indistinguishable from the state retail institutions, the only difference being that the Government controls them through the Central

Co-operative Organisation instead of directly through the Commissariat for Internal Trade.

Broadly speaking, all private incomes are directly derived from the State; the money turnover in the free peasant market and in private enterprise and private employment is insignificant. It therefore follows that retail prices are determined by the total volume of state payments in the form of wages and for the purchase of peasant produce. A glance at a few Soviet statistical figures indicates without any doubt that between 1931 and 1934 retail prices increased because the purchasing power of the population expanded more rapidly than the supply of consumption goods. In 1934, compared to 1931:

	Per cent.
Total wages and salaries rose by . . .	94
The note circulation rose by . . .	61
Output of light industry rose by . . .	23
Value of retail trade turnover rose by . . .	143

From these figures it would appear that retail prices on the average must have doubled during the period and, taking into consideration the increase in state collections of agricultural produce, together with the tendency for the price paid to rise, the total effective purchasing power of the population must have likewise doubled. It would also seem that there has been an increase in the velocity of circulation and this is just what might be expected.¹ At the beginning of the period nearly the whole distribution of retail goods was rationed. This meant that the individual, after buying his ration quantities, found it difficult to spend the

¹ According to an article contributed to the paper *Ekonomicheskoye Zhizn* at the end of August 1933, every rouble in circulation returned to the State Bank 5.7 times during the year 1931 and 8 times during the year 1934.

balance of his income. "Commercial" trade in 1934 accounted for about 25 per cent of the total retail trade turnover, compared to nil in 1931 and only some 3 per cent in 1932. The opportunities for spending have therefore enormously increased and to-day no worker is forced to keep money in his pocket for lack of the opportunity to spend it. At the same time the volume of private deposits in the Savings Bank has been steadily increasing, and this has also played a part in keeping down the currency in circulation.¹

As has already been explained (§ 5), consumption goods, except bread and cereals, are sold by the State at two distinct retail prices, the "normal" and "commercial". Since supplies at the "normal" price are limited by rations, the "commercial" price of any article depends on that proportion of the effective demand not satisfied by the ration. The true price of any article should therefore be a weighted average between the "normal" and the "commercial" prices. This price cannot be fixed by the Government in the same way as wholesale prices are fixed, for the Government cannot plan the desires of the individual citizen; it can only control his consumption by manipulating prices. The price at which the whole output of any retail commodity can be turned over in exact harmony with the rate of production can only be discovered empirically. The demand at a given price for any given article may also change according to whether a greater

¹ Deposits in the Savings Bank are only to an insignificant extent true savings deposits. The Savings Bank is the only bank which accepts private accounts, and the habit of keeping ready cash on current account instead of in the pocket is growing. Most of the better paid employés and officials now pay rent, rates and other such regular payments by means of automatic transfers from their current accounts. All this naturally tends to economise the use of bank-notes.

or less proportion of the total amount available is sold at "normal" or "commercial" prices. For these reasons retail prices in Russia are certainly no more free from fluctuations than in capitalist countries.

The Five-Year Plan provided for an extremely high level of saving, and until the capital invested in industrial expansion has its full effect on production of consumption goods national consumption must be restricted. The extent to which saving has been carried out may be judged from the following figures of workers employed in the production of capital and consumption goods:

	1920	1928	% of Increase
Workers engaged in manufacturing capital goods .	Thousands 1767.8	Thousands 3047.4	72
Consumption goods .	1212.7	1592.5	31
	2980.5	4639.9	50

Obviously the increase in the number of persons employed in industry did not mean a corresponding addition to the consuming population. But most recruits to industry came from the peasantry and had previously lived to a large extent on their own products and had bought very little in the organised retail market. When they left their villages and became paid workers they immediately entered into competition with their fellow-workers for a share of the limited supply of consumption goods. At a constant wage-level prices were bound to rise, but as money wages were actually increased prices rose correspondingly more.

In some quarters the Soviet Government has been accused of inflating the currency, on the grounds that while the circulation expanded, the purchasing power of the rouble contracted. This cannot be denied, and

if inflation means a fall in the purchasing power of the currency, then there was inflation. But inflation as experienced in many countries just after the War also involved a redistribution of the national income and to some extent of the national wealth. In Russia this was not the case, because rising prices affect everybody impartially, since all are buyers and none is a seller, except the peasants, who, inasmuch as the prices paid them by the State for their produce lagged far behind the prices they had to pay for manufactured goods, became worse off in contradistinction to the peasants in Central Europe, who, in many ways, benefited from the post-War inflations.

In a capitalist economy prices are a decisive factor in economic development. The price of goods determines whether the output shall be increased, contracted or remain constant; prices determine whether it is more profitable to produce one sort of commodity than another and the price of capital—that is, the return on investments—is probably one of the factors in determining the proportion of income saved. In Russia the whole process is reversed; the price of goods is determined by the Government's policy. The higher the price the more the Government has restricted production. The Government decides that so many million pairs of boots, so many million yards of cloth, etc., shall be manufactured and distributed among the population in the course of the year. Price has nothing to do with the programme, which depends on the amount of material and labour the Government considers it expedient to allot to the manufacture of consumption goods. Labour is remunerated by wages paid in roubles, which are principally distinguishable from labour vouchers because their possessor holds a store

of value that can be converted into goods or services at will instead of giving him the right to receive stated amounts of specific goods or a claim on certain defined services. The price of an article depends on the relation between the supply and the total volume of roubles the population in the aggregate is willing to set aside for the purchase of that article. This is the normal reaction of supply and demand, and if the price rises it should indicate to the Government that the supply of that particular article ought to be increased, but it provides no incentive to the Government actually to increase its manufacture. To administer the country, carry out its economic development plans, feed and clothe the army, etc., the Government does not really need money in the same way that a capitalist Government does. It requires labour first to make and then to operate the machines which convert natural resources from potential into actual wealth. A part of the actual wealth produced must inevitably be consumed by the labour, but if less is consumed more remains at the disposal of the State. Therefore although the prices of retail goods may rise and their manufacture show a higher money profit, to divert more labour to their production would only mean taking labour away from the production of capital goods and reducing the national savings and the surplus wealth at the disposal of the State.

During the early years of planning, when there was comparatively little spread between the higher and lower wage rates—in other words, when monetary incomes were on much the same level—the actual level of retail prices was of minor importance, since every worker and employé received about the same proportion of the available consumption goods, differences

being determined almost entirely by the individual's ration category. When "commercial" trade became an important factor in retail distribution, prices gained in importance. Greater differentiation in wages were also introduced with the result that differences began to appear in class demand. To-day the higher-paid officials, after satisfying their demand for the essential necessities, can afford to buy goods of a more or less luxury character and to give play to their personal tastes and choice. The time has passed when almost anything could be sold because of the urge to convert surplus roubles into something tangible. In this way a privileged class is being created as surely as it was under the rationing system, and the attitude of the private individual towards money is becoming more like that of his capitalist opposite number.

§ 8. THE GOVERNMENT'S AGRICULTURAL PRICE POLICY

In buying produce from the peasants the Government pays out money in the rôle of a purchaser, but it has the absolute power to fix the prices it pays. It possesses this power because it possesses the means of taking the peasants' produce by force. In practice it compels the peasants to hand over a certain fixed quantity of produce for which it makes payment at a fixed arbitrary price. The Government also possesses the means to bring very strong pressure on the peasants to sell additional quantities of their produce through its power to supply or withhold the manufactured goods which the peasant wishes to obtain in exchange for his produce. But the Government has discovered by experience that there is a minimum price below which the

peasant cannot be compelled to produce. In the early days of the Revolution, during the attempt to do without money and when industrial production had almost ceased, grain was forcibly confiscated from the peasants, with the result that they refused to sow and there was a disastrous famine. Had the Government not confiscated grain the town population would have starved, because the towns were producing nothing to offer in exchange for foodstuffs. Later on, between 1930 and 1933, the principle of forced collections was covertly revived. Payment was made, it is true, but the prices paid were so small in comparison with the prices of industrial goods that the peasants regarded the collections as tantamount to confiscation and again there was a famine in the winter and spring of 1932-33, which directly and indirectly caused the deaths of some millions of people.¹

¹ This is not the place for a criticism of the ethics of the Government in regard to the famine of 1932-33. The bare facts are that the peasants refused to fit into the socialist State and in particular declined to participate in the Five-Year Plan. Because of the Government's decision to create an industrial State in the shortest possible time it was necessary for the country as a whole to save a very large proportion of the annual production. All sections of the community, therefore, had to curtail consumption; but the peasants, who had been already antagonised by forced collectivisation, thought, with some justification, that they were being exploited in favour of the industrial workers. Certainly the quantity of manufactured goods obtainable for the money paid for their produce was ridiculously inadequate. As a result of the peasants' passive resistance in 1931 and 1932, coupled with drought in some regions, the harvests were poor, but the Government enforced its full demands, telling the peasants that if they were short of food it was their own fault. Since then the peasants have apparently worked more energetically and efficiently, having realised that the alternative is starvation. The peasants undoubtedly were threatening to hold up the Five-Year Plan, and, had the Government not taken drastic measures, the struggle with the peasants would have continued probably for some years. The practical outcome is that the peasants are now prepared to work for a considerably smaller reward than formerly. It must at the same time be noted that enforced capital improvements in the collective farms absorb a not negligible part of their net income.

The famine taught the peasants that any sort of resistance to the Government was futile and they are now prepared to work on the Government's terms. But as it is not in the interests of the country as a whole that agriculture shall be depressed through lack of tools, implements and machinery or through the physical debility of the land workers, it may be supposed that the Government buys agricultural produce at a price that will enable the peasants to cover their minimum requirements of manufactured goods and food consistent with efficiency. Thus the prices paid for agricultural produce must bear some relation to the prices at which the Government supplies manufactured goods to the peasants.

The needs of the peasants differ according to the class of crop they produce. In the grain areas the food of the land population is mainly provided out of their own crops, therefore the Government must not collect so much of the harvest that the food supply of the growers is reduced below the minimum required to keep them and their cattle in efficient physical condition. If the collectivised peasants be regarded as state agricultural workers their remuneration consists of the quantity of produce they are allowed to keep for themselves plus the money value received in exchange for the State's quota. The latter represents the purchasing power they require for a part only of their necessities. In regions devoted to the cultivation of industrial raw material, *e.g.* cotton, the State buys the whole of the crop and the peasants are dependent on the money value received for practically the whole of their requirements, for they can produce only a limited quantity of vegetables and fruit for themselves. They must buy not only manufactured goods but their

staple food requirements from the State at the prices fixed by the State. It would seem, therefore, that prices are of somewhat more consequence to the growers of cotton, etc., than to the growers of grain. But in neither case is there any real incentive to the peasants to increase production above a certain maximum which enables them to enjoy the maximum consumption allowed by the State. For while the Government will not part with the goods it has to distribute except at a price, the amount of such goods is limited, and any excess purchasing power in the hands of the peasants is more or less useless and superfluous. At least the effort to realize such purchasing power is probably incommensurate with the resulting satisfaction. For although in all important towns it is possible to buy all sorts of consumption goods at "commercial" prices without restriction, the peasant, to exercise his surplus purchasing power, must journey to the nearest town in which there is a "commercial" shop, and the time and expense involved in the journey is, of course, a deterrent in proportion to the distance to be traversed.

On what system the Government fixes the buying prices of agricultural produce is not divulged, but there must logically be maximum and minimum limits automatically fixed by two sets of considerations. The minimum limit is that which in normal circumstances will give the peasant grower sufficient purchasing power to enable him to buy essential manufactured goods, additional or supplementary foodstuffs, pay his taxes and collectively carry out the planned capital improvements on the farm and pay interest on the loans and short-term credits granted to the farm. The maximum price would be determined by the consideration that beyond a certain point the incentive to

produce would be reversed. Thus, when the peasant, either individually or collectively, finds that an increased monetary income fails to increase his power of consumption he will not be interested in earning more money. An increase in the price received would not inspire him to greater effort, but would rather enable him to take life more easily.

The only approach to market prices for agricultural produce is found in the peasant and collective-farm markets in the towns, where produce is allowed to be sold to the consumer direct at whatever price can be obtained. As in all Eastern bazaars, and in Russia also before the Revolution, prices are determined by bargaining between buyer and seller. Only those peasants who live within a certain radius of a town can avail themselves of these markets, for middlemen (or speculators in Soviet terminology) are strictly prohibited. The peasants who bring their surplus produce to market can, of course, spend the proceeds at the "commercial" shops. This provides a definite incentive to produce a surplus for the open market and the prices obtained are those the town consumer is prepared to pay. This again depends on the prices charged for similar goods in the "commercial" shops. Thus the competition which has developed between the peasants and the State as distributor is responsible for a material reduction in the prices of such things as butter, eggs, milk, flour, meat, etc. In February and March 1935 prices on the Moscow free market had fallen in comparison with prices twelve months before as follows:¹

¹ *Ekonomicheskaya Zhizn* of 4th April 1935. In Rostov on Don at about the same date, pork was being sold at R.10 per kilo, butter at R.20, wheat at R.20-15 per pood (16½ Kg.) and rye at R.15-15 per pood. These prices are roughly 10 to 20 times the equivalent pre-War rouble prices and up to 10 times the gold rouble prices quoted in the

Butter by 24·3 per cent
Milk by 36 per cent
Wheat flour by 36·2 per cent
Sour cream by 18·2 per cent
Rye flour by 44·4 per cent.

In Kiev between January and the beginning of April 1935 the prices of the following articles were reduced as follows:

Eggs from R.7·30 per 10 to R.4·80.
Milk from R.2·10 per litre to R.1·80.
Beef from R.9·70 per Kg. to R.9

The foodstuffs sold by the "commercial" shops are mainly bought from the peasants, the only alternative source of supply being the state farms. These are mostly engaged in grain-growing, cattle-breeding and cultivating technical crops, and supply insignificant quantities of milk, eggs, vegetables, fruit, etc., to the retail organisations. The prices paid to the peasants for compulsory deliveries or for purchases at conventional prices are, of course, far lower than those ruling on the free peasant markets, and consequently the "commercial" shops have a big margin for reducing prices when it is desired to undercut the free market. The limit to which prices can be lowered depends in the long run on demand. If prices were fixed too low

Torgsin shops. A fair average wage for workers in large-scale industry before the War was about R.240 per annum, and in 1934, according to the Soviet Statistical Annual, the average was R.1791, *i.e.* over 7 times as much, and wages have further increased in the meantime. But any deduction regarding the relative cost and standard of living is vitiated by the taxation, subscriptions and levies for state loans, social insurance and various other purposes which the worker is compelled to pay to-day, and by the fact that he enjoys various social services and cultural amenities which did not exist, or only to a very limited extent, before the War.

in the "commercial" shops, supplies would be sold out and the unsatisfied consumers would be forced to buy on the free market at higher prices. It is clear that open-market conditions must in the long run govern prices on the "commercial" and free markets, and the fall in prices which became marked at the end of 1934 was largely due to increased offerings of produce as a result of the improved opportunities afforded the peasants for spending money on manufactured goods.

The Government's price policy with regard to agricultural produce if analysed seems to show two distinct aspects. In one, by far the most important quantitatively, the underlying principle is strongly tinged by coercion, while in the other an appeal is made to the normal human desire for gain. The latter, by all available information, seems the more efficacious. As we have seen, the collective farm has to surrender to the State a fixed quantity of produce at a low price and is under strong pressure to sell the rest of its surplus to state organisations at prices not very much better than the compulsory price.¹ On the average, the divisible money income of a collective farm is probably roughly sufficient when shared out among the members to enable them to buy as much in the way of clothing, tobacco, tea, sugar, etc., as is made available by the state retail system, assuming, of course, that access to a town "commercial" shop is impossible. The prices fixed by the Government for compulsory and conventional deliveries of produce should be, and on the average probably are, just about at a level which, given a normal season, allows the individual member of

¹ An important modification of the Government's grain-purchasing policy was introduced at the beginning of 1936. It is discussed in an appendix to this chapter.

the farm to earn this norm by ordinary steady work. Prices and the scale of compulsory deliveries vary according to the fertility of the region, so that earnings are more or less equalised, and in a sense it can be said that the more fertile regions subsidise the less fertile. Whether the price-fixing commission examines all the relevant factors in detail to arrive at the fixed price is impossible to say, but prices have been steadily rising since the system began, and there is some indirect indication that a conscious effort is made to adjust the level of agricultural earnings to the supply of goods or to a less extent adjust the supply of goods to earnings, or finally, and to only a small extent, adjust the prices of goods to earnings. The detailed methods of price planning are kept secret and the above surmise might be quite wide of the mark; but it is plausible, and even if it be false it fits the facts and does not alter the conclusion that the remuneration of the ordinary collectivised peasant is more in the nature of wages than the reward of private initiative, except in the case of those fortunate enough to live in the neighbourhood of a large town provided with free peasant markets and "commercial" shops. However, the extension of "commercial" trading and the free peasant markets is definitely a part of the Soviet Government's policy.

§ 9. THE FORMATION OF WHOLESALE PRICES

For want of a better word, "wholesale" may be used to denote the prices at which material and goods are exchanged between state enterprises, e.g. the sale of coal by the mining trusts to factories, of iron and steel by the foundries to the machine works, of raw

cotton by the cotton-collecting organisation to the spinning mills, of yarn by the spinning mill to the weaving mills, of the finished cloth by the textile selling organisations to the wholesale organisations of state and co-operative retail trade. It also includes the value of services, *e.g.* the contract price at which a state building trust erects a new building for a manufacturing enterprise.

Wholesale prices are essentially accounting prices and are governed very little if at all by considerations of planned distribution. That is not to say that wholesale prices are not planned, but price-fixing is not used as a means of directing or controlling industrial consumption. It is not necessary since the material production plan determines the industrial programme, including the distribution of raw material and labour and the resulting volume of output. For instance, the available supply of coal is rationed out among the various industrial combines and trusts, railways, etc., in accordance with their planned requirements, which of course depend on their planned production. In practice, every coal-consuming enterprise concludes a yearly, half-yearly or quarterly contract with a coal trust for a given quantity of coal to be delivered in certain amounts at certain stated intervals. The consumer is theoretically limited to a total quantity proportionate to his output of finished goods; the price is that fixed for the particular quality of coal he requires and the contract must be made with a particular coal trust. The consumer cannot advertise for tenders and make his contract with the seller who offers the best terms. The same principle applies to all contracts for the sale of material and goods between industries.

The price of any commodity is based on the planned production costs, which are arrived at by calculating the average actual costs for the previous year and deducting the planned decrease in production costs for the current year. Planned costs are therefore largely founded on previous experience. Presumably the original basis was the actual costs at the close of the N.E.P. era when a wholesale market existed more or less effectively and when industrial enterprises were, in comparison with the planning era, dependent on their own resources and had to pay their way. During the N.E.P. period all industrial enterprises, except a few operated by foreign concessionaires, belonged to the State, a municipality or some other public body or a co-operative society, as they do to-day, but they were far more dependent on themselves and therefore cost accounting was necessary both in the interests of economic management and operation and to determine whether the enterprise was working at a profit or loss. Although profits and losses are not such vital considerations to-day, costing accounts are equally necessary from the point of view of the State as the ultimate owner of all the means of production. For accounting offers the best and indeed the only effective means of controlling waste and extravagance, and comparing the relative efficiency of one enterprise with another. Without this check it would be impossible to lay down a standard of efficiency by which all the various enterprises in any industry may be judged.

The price at which a producing enterprise sells its finished product should cover the original cost of all raw material, consumable stores and other goods, labour, depreciation and replacement of fixed assets, administrative costs and certain secondary expenditure

not strictly connected with manufacture, such as the maintenance of a technical instructional department or annex for students or apprentices, and in addition a planned percentage of profit on the turnover. This profit, or the difference between the selling price and total production costs, is divided into three parts. One part goes to the State as a budgetary contribution, another part is paid over to the Prombank as a contribution to the funds for general industrial capital development, while the third part remains at the disposition of the enterprise or the trust of which it is a unit. This last part is designed mainly to finance capital improvements and extensions, but to a certain extent may be used to improve the living conditions of the workers, for instance to establish clubs, crèches, factory canteens, kitchens and refectories. Charges on account of rent for ground or premises and interest on capital do not arise, except in special circumstances when, for instance, one enterprise pays for the temporary use of a building, say a warehouse, belonging to another enterprise.

Theoretically every enterprise should make its planned profit, unless for some reason its plan provides for a loss. This only occurs in the case of relatively costly but economically important manufactures, the full cost of which would tend to prohibit their use. For instance, in the early days of the Soviet tractor industry the production costs of home-made tractors was very high. This tended to discourage state and collective farms from buying Soviet machines and stimulated the demand for foreign tractors. Of course it would have been quite within the Government's power to give grants or loans to the farms for the purpose of buying Russian tractors, but it preferred to

fix a selling price considerably below production cost and make up the loss to the factories by means of subsidies. Such cases are the exception and as a rule industrial plans provide for a profit. Yet out of 100 balance-sheets of combines, trusts and enterprises for 1934 taken at random, 60 showed profits and 40 losses. Even allowing that some of these losses were planned, the figures would seem to indicate that on the whole planned costs are too low; alternatively that planned wholesale prices are fixed below their true level. This in itself is immaterial because the losses in the long run fall on the State, which makes correspondingly greater profits from the difference between the wholesale and retail prices. But losses may be due to over-optimistic planning or to bad management and waste in the enterprises themselves. Since detailed planning was introduced with the first Five-Year Plan, the planned reduction of production costs for industry as a whole has never been realised in any year. It is a moot question whether the planning commission has consistently taken a too optimistic view of the possibilities of improving industrial efficiency or whether industry as a whole has lagged behind. In any case had cost-accounting and planned wholesale prices not been adopted there would have been even less control of industry.

It is conceivable that industrial efficiency would have been better, that there would have been less wasteful consumption and a better standard of quality in output had prices been allowed to find their own market level. But that would have cut right across the whole principle of planning. It would have hindered industrial development, for the enormous potential demand for all sorts of consumption goods would

inevitably have diverted both material and labour away from the production of capital goods to the manufacture of consumption goods. It is difficult to see how any Government interference in the way of rationing material and labour in accordance with its development plans could have been effective without simultaneous price control. Even in existing conditions of strict control and price fixing, the payment of surreptitious premiums to obtain delivery of urgently required material is by no means unknown.

The defects of fixed wholesale prices are that they do not represent the true social value of commodities and, based as they are on theoretical production costs, they encourage quantitative production at the expense of quality. So far, no really effective corrective to this undesirable feature has been discovered. Fines and penalties provide no satisfactory remedy, and to allow differential prices to provide an antidote would create difficulties in other directions. Price fixing may also result in restricting the production of goods for which the demand is strong and encouraging the further production of goods of which the supply is relatively adequate. It is impossible to calculate the wholesale price of a number of articles produced by a single enterprise so accurately that it is equally profitable to manufacture every one. Owing to miscalculations it sometimes happens that the wholesale selling price of one article is fixed so low that its manufacture involves an inevitable loss. As an actual case in point, it once came to light that the planned wholesale prices of ordinary domestic aluminium utensils involved the manufacturer in a loss of about R.1.50 on every saucepan turned out, while the planned prices of other articles, say spoons and forks, were much nearer the actual

production cost. Any enterprise will naturally do its best to avoid manufacturing articles which it must sell at a loss and will concentrate on those articles which return a profit. The result is that a restricted output of saucepans will intensify the demand and equilibrium must be maintained by increasing the retail price. The converse happens in the case of spoons and forks. Exactly the same thing happened in the case of the production of spare parts for tractors; the factories concentrated on turning out simple and easily made parts and neglected the more complex and costly ones. In this case the prices need not necessarily have been out of proportion, but the manufacture of the simpler parts gave less trouble and the proportion of "brack" (throw outs) was less, and therefore it was easier to fulfil gross production plans by making excessive quantities of a few standard articles. Presumably as a result of this experience it was decided in 1935 to sell tractor spare parts on a "commercial" basis. That is, the Machine Tractor Stations and state farms were thenceforth able to buy spare parts without restriction at retail shops instead of sending indents to the manufacturing trusts some time in advance. The "commercial" retail prices were naturally determined by the intensity of the demand, and as a result there arose a direct incentive to produce the higher-priced articles and to stop producing an excess of the cheaper parts. Obviously, unless the new retail prices were allowed to affect the manufacturer's selling price the altered method of distribution would have been pointless, for they would have had no more influence on production than the high retail price had on the output of aluminium saucepans.

Production costs are determined very largely by

labour costs, more so in Russia than in capitalist countries since there is no remuneration of capital in the same way. Though the order of industries in respect of wage rates is not very strikingly different to industry in capitalist States, the differences between wages in different industries are greater. The highest paid workers in Russia (1934 statistics) on the average are those engaged in oil production followed by those employed in engineering works, while the lowest are the textile operatives. The machinery factory hand is paid over 70 per cent more than the linen mill operative. These are extremes, but all wages in heavy industry are considerably above those in consumption industries and there is a marked gap between the lowest wage in heavy industry and the highest earnings in consumption industries.¹ The wholesale prices of consumption goods should therefore be cheaper in comparison with the cost of capital goods than in capitalist countries. Since the demand would be overwhelming for all consumption goods if their retail prices bore a more or less normal relation to production costs, consumption was restricted by rationing a part of the retail trade and selling the balance at prices inflated by the inclusion of a heavy turnover tax. In 1934 about half the turnover value of retail trade consisted of this tax. If the retail selling price of a commodity is on the average about twice the actual wholesale price, there is obviously an enormous margin for adjusting retail prices to demand without affecting the wholesale price.

¹ Light industry naturally employs a greater proportion of female labour than heavy industry, but the principle of equal wages for equal work holds good. Any inequality in the earning power of the sexes is due to differences in their physical capacities and not to differential wage rates.

If all prices were accurately planned, wholesale prices would represent the prices at which commodities could be sold to cover all the costs of their manufacture plus amortisation and standard profits, and thus, according to the Marxian theory, which holds that the value of an article is measured by the amount of labour-time consumed in its production, it would be possible to compare the values of different commodities. But the circumstance that retail prices in the unrestricted "commercial" market have to be adjusted by the inclusion of varying percentages of turnover tax conclusively shows that Marx's notion of value and that of the ordinary consumer are very different. At the present time (1935) the ordinary Soviet worker would doubtless be ready to pay much more for a pair of boots than for, say, a dinner service, though the cost price of the two things might be approximately the same. During the first quarter of 1935 the factories under the Chief Administration of the shoe and leather industry produced 9.15 million pairs of footwear. If they produced in the whole twelve months 40 million pairs, about one person in every four in the Soviet Union would be able to buy a new pair. The retail price of boots is therefore very high compared to other commodities costing about the same to make, but not so essential to the ordinary citizen. But because the intensity of the demand must not interfere with the Plan, which incidentally provided for the manufacture of 9.12 million pairs of boots in the quarter, the wholesale price must also be planned.

In capitalist economy the system of prices has evolved gradually from the barter stage of exchange. It may be said that prices in the broadest sense are the substance of monetary economy which might

somewhat irreverently and tersely be termed the study of what the average man would be willing to pay for a given thing in given circumstances. The Soviet system has evolved a different conception of price. The notion is more or less that the price of any article should correspond with its production cost in labour-time. In attempting to put this theory into practice prices have been reduced to a mere formula which lacks reality. As a consequence of this, money in industry and even in wholesale trade does not really represent a purchasing medium so much as a common unit in which goods, material and labour-time can be expressed; in other words, it operates only as a unit of account.

§ 10. FOREIGN TRADE UNINFLUENCED BY INTERNAL PRICE-LEVELS

In the foregoing sections we have seen that prices at which the Government makes purchases and at which the commercial transactions between state enterprises are denominated are arbitrarily fixed, while average retail prices must reflect the relation between supply of and demand for consumption goods. Before prices could be planned and fixed, private trade and private enterprise had to be abolished, especially all private enterprise in foreign trade. Foreign trade, when carried on as a state monopoly, is governed by different rules and principles than private trade. Private enterprise will only import or export goods if by so doing it earns a profit, but to determine whether a profit will be made it is necessary to compare the costs and prices of different articles after converting foreign currencies into the domestic currency. A state monopoly pays no attention to price relations. It

is concerned only to achieve a balance of foreign payments. It may, of course, incur debts in foreign currency and it can equally well become a lender of foreign exchange, but nothing can affect the internal currency nor internal prices, for, if the internal currency is to fulfil the functions of a planned currency, it must be isolated from all others.

Logically, when planning its foreign trade the Soviet Government should be guided by the consideration whether it is worth while exporting a given quantity of grain, oil, timber, etc., in return for a given quantity of iron, steel, machinery, etc. The internal prices of grain, oil and timber have nothing to do with the decision, because the Government is taking a long view and considers that the machinery, etc., needed for the economic development of the country is worth a temporary restriction of the people's food supply and that the advantages to be reaped from the acquisition of the imported goods outweighs a temporary restriction in the consumption of timber and oil. For example, iron is more suitable than wooden rafters for roofing large factory buildings, and it might well be considered better policy to export timber and import iron even though this meant some slowing-down of the building programme. But if the price of timber abroad fell or that of iron rose, a time would come when the increased timber exports needed to finance the same quantity of iron as before would involve a disproportionate restriction on the internal consumption of timber. It would then be better to keep the timber for use at home. This argument in principle applies to capitalist trade, but the difference is that the Soviet Government has no guide except its own assessment of the relative value to it of the exported and imported goods. In capitalist

international trade, price is the ultimate arbiter. Price will show whether, in the opinion of the people as a whole, it is worth exporting some home product that can with more or less sacrifice be dispensed with in return for gratifying a desire for imported goods. It is fairly safe to say that had a free market operated to direct Soviet foreign trade, the verdict of the people would have been very different from that of the Government.

At the beginning of the Five-Year Plan the Soviet Government was prepared to pay high prices for imports. It would probably be not far short of the mark to say that it paid no attention to relative values, but exported everything that could possibly be spared and a good deal that could be very ill spared, and imported as much as it could buy with cash or credit. Later on it began to realise that imports might be obtained too dearly, and more attention was paid to the internal demand for the products that had been formerly exported. Thus exports contracted and simultaneously imports had to be curtailed; and when giving orders the Soviet Government became much more exigent regarding terms and prices. It was no longer ready to buy at any price, but wanted good value.

In the early years of the N.E.P. period there existed a bourse, or rather an official and an unofficial exchange market, in Moscow, in which the difference between rates was not very great. The introduction of the stable and officially gold-backed chervonetz brought out of hoard a very considerable quantity of foreign currency, though the chief buyers and sellers of foreign exchange were state institutions concerned in foreign trade. The foreign trade monopoly was not centralised at once and, subject to certain control, state enterprises were able

to engage in export and import up to 1925 or 1926 more or less on recognised capitalist lines. That is to say, it paid them to import if they could sell their imported goods for sufficient roubles to cover their foreign exchange outlay and yield a surplus. At the same time it paid to export if the roubles realised by the sale of the foreign exchange covered the total outlay on the exported goods. Thus in 1923-24 the state grain-exporting department was able to buy grain freely from the peasants and export it at a profit. That was because the peasants had a considerable surplus of grain and retail prices were largely influenced by the price of imported consumption goods. During the War and the subsequent revolutionary troubles, the supply of consumption goods to the Russian peasantry had continuously and rapidly declined until after the famine of 1921 and 1922, when there was an enormous accumulated demand for all sorts of industrial manufactures such as textiles, hardware and the like. As a result of a relatively good harvest in 1923 the peasants were ready to pay a high price in produce for the simplest necessities. In the subsequent years, when private enterprise in retail trade had revived and the scarcity of manufactured goods was less intense, the peasants became more difficult to please, demanding a better exchange for their produce, and the state trading organisations found it increasingly difficult to obtain supplies. The Government, being unwilling to increase prices, was forced to employ coercion until in the years 1931 and 1932 grain was to all intents requisitioned at prices not much more than those for which the peasants had been prepared to sell voluntarily in 1923.

It is clear that, had the state exporting organisations continued to operate on the original lines, they would

soon have found it impossible to export at anything but a loss. Alternatively the exchange value of the rouble would have fallen to a small fraction of its theoretical gold parity, for there has never been a vestige of a free gold market. It was probably sometime in 1926 or 1927 that foreign trade became entirely divorced from the internal cost of export goods or the rouble prices of imported goods. Since then it may be said that goods have been imported for their intrinsic utility and not because the internal demand made it profitable. For these reasons it is absolutely impossible to calculate whether Soviet exports are sold at a profit or loss. It is impossible by means of figures to substantiate any charge of dumping on the part of the Soviet Government, though it is easily demonstrable that the internal rouble prices of most, if not all, export articles are much higher than the export yield converted into gold roubles. But this means nothing, as there is no method of correlating rouble costs with world costs.

An eminent Russian economist¹ recently published some comparative prices of which the following are an example:

	Gold Kopeks per Kilo		Paper Kopeks per Kilo in 1934	
	Retail Prices in Moscow, 1913	Export Prices, 1934	Prices paid to the Peasants	Prices charged to Retail Buyers
Butter .	114.8	25.6	250	2600
Sugar .	34.2	10.2	..	750
Poultry .	..	34.7	..	1400
Oats .	5.2	2.4	5.5	75
Flour .	12.2	10.8	..	340
Wheat .	..	2.8	10.1	..

These figures show that not only is the Government

¹ Professor S. N. Prokopovich, Principal of the Slavonic Institute in Prague.

ready to sell goods abroad for, on the average, something less than 2 per cent of the nominal price obtainable internally, but that the export prices are less than 12 per cent of the nominal prices paid to the peasant producers for the same commodity. On the face of it this might be taken to mean that the Government would as soon sell butter abroad for about 7d. per kilo as at home for about £2 : 15s. But in actual fact the Government has a surplus of butter after satisfying the minimum home requirements. If it distributed this surplus for internal consumption it would get a very insignificant return in the form of labour, which is the only thing the supply of which is in any sense a subject for bargaining between the Government and the population. Therefore it pays to sell this surplus abroad at a very low price and import foreign goods which it cannot obtain internally. It follows, therefore, that the internal price of a commodity has no bearing on its export. The decisive question is whether there is a surplus over minimum internal requirements.

The Soviet Government also exports a certain amount of industrial manufactures including such things as agricultural machinery, the internal demand for which for productive use is by no means saturated. Probably this form of export is dictated by propaganda reasons. It is questionable whether it is possible to arrive at even the roughest estimate, whether the prices obtained cover actual manufacturing costs. The real test is whether the money obtained for, say, a Soviet reaping machine abroad enables the Government to import something equally or more valuable from its own point of view. The internal utility of a reaping machine is more or less calculable and tangible, whereas the internal value or utility of a ton or so

of butter is quite intangible. If distributed among shock workers it may have a certain positive value in stimulating them to work harder, but this is problematic. If sold to tourists in the foreign currency hotels and restaurants it becomes much more valuable, since it then produces the means of importing something that is not produced internally. As a point of interest there is evidence that since 1933 the general demand for an improved standard of living has exerted increasing pressure on the Soviet Government to retain a greater proportion of its home-produced consumption goods and export less. The population, or at any rate the industrial worker class, was not prepared indefinitely to put up with the privations of the first Five-Year Plan and gave the Government to understand that it was time its promises of better conditions were honoured.¹

§ 11. THE SOVIET PRICE THEORY

It has been shown that in the Soviet system "price" has a different meaning and is the result of a different set of circumstances from those in a capitalist system. It is necessary to get a clear understanding of this before it is possible to grasp the real principles and conditions governing the whole financial and monetary system. Price and value are not the same thing except in the retail market where the individual citizen, having a certain sum to spend, lays it out on things that will afford him the maximum satisfaction. But in industry and wholesale trade the prices of two different

¹ Just after the New Year 1936 the Soviet Government officially announced that it intended curtailing or in some cases ceasing the export of a number of consumers' goods, such as textiles, foodstuffs, furs, etc., in order to increase the supply available to the people.

articles do not reflect their relative value or utility, but only approximately the number of labour-time units consumed in their manufacture. This serves as an accounting price and makes possible a system of costing. In a capitalist system production is regulated by prices; but the communist doctrine holds that prices which are determined by supply and demand are inferior to planning as a guide to production because the latter is scientific, and anyhow the demand in capitalist systems is made up of the aggregate desires of the population, who do not know what is good for them.

APPENDIX TO CHAPTER XIV

PREMIUM PAYMENTS AND THEIR EFFECT ON PRICES

At the beginning of 1936 the Soviet Government introduced a system of premiums in connection with its purchases of agricultural produce from the collective farms. This renders parts of the foregoing chapter out of date, particularly § 8, which must now be read in the past tense so far as it is superseded by this appendix.

A decree published in February 1936 announced that in future the government price paid for voluntary sales of wheat by collective farms after fulfilling their compulsory deliveries would be increased according to the quantity of such voluntary sales. Thus a collective farm selling to any state organisation between one and five tons in addition to its compulsory quota would receive a premium of 10 per cent on the basic price for the whole of the additional quantity. For voluntary sales up to ten tons the premium would be 15 per cent for the whole quantity, and so on until for the whole of any additional sales

amounting to over 100 tons the price paid would be 200 per cent of the basic price. In the same way premiums would be paid for quantities exceeding ten kilogrammes sold to the State by individual peasants out of their own produce or share in the collective farm's harvest.

The principle of promoting results by additional rewards was introduced into industry in the early part of the first Five-Year Plan. Then it took the form of special privileges to buy extra quantities of rationed goods. Since rationing was abandoned those workers who perform more than their "normal task" receive money premiums which increase according to the amount by which they exceed their norm. In the building trade, for example, a worker whose output exceeds his norm by over 20 per cent is paid at double rates for everything in excess of his norm. This method of "speeding up" production is, of course, strongly deprecated by capitalist labour and trade unions.

The device of encouraging increased production by offering additional money rewards could only be exploited when the available flow of consumers' goods was sufficient to satisfy demand at current prices. This condition was completely realised only at the end of 1935; even then, in order to equalise supply and demand, the retail price level had to be raised much above the former ration prices.

At first sight it would seem that the payment of premiums for additional deliveries of agricultural produce (the system is not confined exclusively to wheat) would mean a rise in average prices when supplies were abundant, instead of the reverse which is the rule in capitalist markets. At the same time farm money-incomes would rise the faster the more abundant the crops, which would seem to lead to an inflationary expansion of demand for consumers' goods. However, if the basic price for produce is purely conventional, that is, not a market price, the average price may be no more than what would be the market price under open-market conditions. Obviously, however, when there is a bountiful harvest the average cost to the Government of wheat will be higher than the average cost when the harvest is only moderate. But there is a very large spread

between the price paid by the State for raw material and the retail price to the consumer for the resulting finished goods. In the budget estimates for 1936 the turnover tax on cereal foods is estimated to yield some R.21 milliard. This means that the total money paid by the consuming population for bread, flour, etc., will exceed by R.21 milliard the total cost to the State of procuring the raw materials, manufacturing and distributing the finished goods. Should the Government, by reason of its new purchasing policy, be compelled to pay a higher price for its purchases of agricultural produce, there is still a very big margin before it would be compelled to put up retail prices; and, of course, it is clear that even if the amount of tax on a unit of produce falls, yet if there is more produce available the total amount on which the tax is collected is correspondingly increased. For a long time to come there is little prospect of Russia's output of agricultural produce exceeding the rapidly growing internal demand in addition to providing for exports. Therefore, there can be no immediate prospect of any device to encourage production resulting in an absolute surplus of supplies. Should it by any chance happen that production increases so rapidly as to endanger the Government's purchasing policy, it is always possible to lower basic prices or to increase compulsory deliveries. The Soviet Government seldom commits itself for more than a year at a time and thus maintains a power of adjustment to circumstances as experience dictates.

It was pointed out above that the system of agricultural premiums will presumably result in a rise of farm incomes. Doubtless the Soviet Government has taken this into account. It is, of course, clear that the more produce the peasants supply the greater will be the output of many of those consumption goods produced from agricultural raw material such as cotton, linen, tobacco, leather, etc. If the Soviet Government correctly estimates all the factors implicit in its new agricultural price policy there should, therefore, be no disturbance of the retail price level. And if experience eventually shows that a miscalculation has been made, it is possible for the Government to adjust its purchasing prices to remedy any disequilibrium.

Also, the Government maintains a large measure of control over collective-farm investments. If, therefore, farm monetary incomes increase very appreciably the Government can decree that larger sums shall be devoted to capital improvements, purchasing additional machinery, etc., and thus relieve the retail market of any inconvenient expansion of consumers' demand.

The system of paying increasing premiums to industrial workers when their output exceeds a "normal" task accords with the accepted theory of "Scientific Management", and so long as the labour cost of the operation is a small part of the whole it encourages the operator to occupy an expensive machine for as short a time as possible on each job and, therefore, tends to reduce average overhead costs. In Soviet conditions, where manufacturing processes are highly standardised and machines are on the whole occupied considerably below capacity, the system of premiums would seem to be peculiarly suitable so long as it is prudently applied. As in agriculture, the Government can make frequent readjustments if experience proves it necessary. In the case of coal mining and other industries where wages form a large part of the costs of the commodity produced, the system would seem of doubtful merit. In conjunction, however, with a better rationalisation of the amount of labour available, it tends to reduce the amount of labour employed per unit of production and, when there is a shortage of labour, this is a distinct advantage.

So long as land is not cultivated to its full capacity and industrial machines are not fully occupied, the premium system doubtless has much to recommend it. But its wholesale application can be only a temporary expedient. In the long run it would result in a general rise in price levels when its stimulating effect on labour and machine efficiency began to decline. And in view of the Soviet Government's proclaimed policy of stabilising the internal commodity value of the rouble, it may be presumed that when industrial and agricultural premiums have served their purpose they will be abandoned as a general principle, being retained only where labour costs are a small part of the whole, or will be neutralised by increasing the normal task or quota or decreasing the basic wage or agricultural price.

CHAPTER XV

SAVING AND INVESTMENT

§ 1. COMPARISON WITH CAPITALISM

IN capitalist systems saving is the act of the individual and corporate income-receiver who refrains from spending the whole of his current income on consumption. Saving for the most part is voluntary, though there are forms of compulsory saving. In some States compulsory social insurance contributions or funds undoubtedly have the character of savings. Budget surpluses which are invested in the national economy are also compulsory savings, for example, when a Government builds a road out of current revenue. The financial effect of compulsory saving on the ordinary citizen is the same as that of voluntary saving, it reduces his current consumption by an equivalent amount. The results of compulsory and voluntary saving will normally be different. The citizen has control over his voluntary savings. He can lend them to an entrepreneur who will pay him interest. Even if he leaves his savings in the bank he will expect some return, which means that the bank must use its clients' savings to earn interest. Voluntary savings will therefore as a rule be invested in some enterprise which earns profits but which does not aim primarily at adding to the material prosperity of the community.

It is peculiarly the function of Governments to provide those things which benefit the community but

which in themselves are non-reproductive in monetary form, or so little reproductive that they could never attract voluntary saving: such things are roads, lighthouses, the army, navy, air force and so on. Current expenditure on these is normally met out of current revenue, but there are times when a single heavy expenditure is required to catch up with needs too long neglected. There are, then, two ways in which the required capital can be obtained, viz. by issuing a loan or by making a levy; that is, by imposing a single *ad hoc* tax on the community. If a loan be issued interest must be paid to attract the savings of the people. But since the proceeds of the loan will have been spent on non-reproductive things, the interest and eventual repayment of the loan must be met from other resources, that is to say, it will be paid out of taxation, which means that the expenditure in the long run is provided by compulsory saving spread over a long time.

The definition of saving in the Soviet Union is the same as in capitalist States. It is the result of the individual refraining from spending the whole of his income on current consumption. This must be so when one comes to think it out. Socialism, in theory at least, means that all means of production belong to the State or the community, therefore every member of the community has a right to a share in the national income, and if he consumed the whole of his share production and consumption would cancel out and saving would be nil. But there is nothing voluntary about Soviet national saving,¹ and only a small part

¹ In order to forestall the criticism that the annual state loan is voluntarily subscribed it may be stated here that, even if the private individual has nominally the right to decide whether to subscribe or

is, so to say, perceptible to the citizen consumer, that part which consists of loan subscriptions and direct taxation. The bulk of the national saving is secured by indirect taxation, by additions to the price of consumption goods.

It is needless to point out that the ordinary citizen has not the slightest voice in controlling the investment of his savings.¹ All savings are concentrated in the hands of the Government, which allots the sums available for investment in accordance with the plan of economic development. There are no special loans issued for specific purposes, such as railway construction. All the capital requirements of the different branches of national economic activity are met from a common pool, with two exceptions that are really more apparent than real. Part of the "accumulations" (which in Soviet economic terminology means the difference between the gross revenue and gross expenditure of an economic enterprise) of industry and trade does not pass through the central budget but is paid direct into one of the long-term credit banks and is redistributed in the form of capital grants. The second exception is of very minor significance; certain levies are imposed on the population for cultural and dwelling-house construction and occasionally subscriptions, nominally voluntary, are collected for a specific

not, the results of not subscribing amount to almost irresistible pressure to subscribe the amount of at least three weeks' salary or wages.

¹ There are certain admirers of the Soviet system who no doubt would claim that the Government is based on a true democracy, and in support of this they would cite the system of elections to the primary Soviets based on practically universal suffrage. In practice all matters of national importance, both political and economic, are decided by the Presidium of the Central Executive Committee. The National Parliament or Congress of Soviets meets at intervals of about four years formally to approve the actions of the Government.

object, such as building aeroplanes. The crash of the great aeroplane *Maxim Gorki* on 18th May 1935 was followed by a call for subscriptions to build a successor, or as a matter of fact several successors. But these exceptions do not alter the fact that the whole of the national saving is directed and controlled by the Government.¹

§ 2. SAVING = COMPULSORY RESTRICTION OF CONSUMPTION

In Soviet finance planning takes the place of a capital market. The two systems are, of course, antagonistic. In principle planning is simpler, it might possibly be called more primitive, than the elaborate system and very complex laws under which Western capital and money markets operate. The Soviet Planning Commission does not have to trouble itself about the effect of bank rate on investment nor the influence of the yield of investments on saving. In effect, all the Planning Commission has to do is to decide what proportion of the national production must be set aside for consumption and what proportion can then be devoted to investment, though, no doubt, working out the details is a highly complicated task.

So far as the ordinary citizen is concerned, the amount of his saving is decided for him for the simple reason that his consumption is fixed, if not precisely

¹ Republican, provincial and local governments and governing bodies have certain limited powers of collecting taxes or levies from their own people for investment purposes, but all this must conform with the Plan. Not long ago it transpired that some village Soviets and similar bodies had been issuing their own private loans to finance their own little local investments. Those responsible were severely dealt with by the Central Authorities.

for every individual at all events for the community as a whole. The Plan provides for the annual manufacture of so many million yards of textiles, pairs of boots, etc., for building so many cubic metres of dwelling-house space, for the production of so much bread and other foodstuffs. The distribution of these goods is not equal, especially since the growth of "commercial" trade, for the citizen receiving a high salary or wage income can obviously buy and consume more than the poorer man. But since the total volume of these consumption goods is fixed by the Plan, no expansion of total consumption would follow if direct taxation and loans were abolished. The only result would be a general rise in prices. Nevertheless the individual wage-earner must feel that if he himself could evade subscribing to the state loan or paying direct taxation he would be so much better off. His purchasing power would be greater in comparison with that of his comrades who continued paying taxation and he would succeed in consuming more of his income and in saving less.

Voluntary saving is so rare that it may be said to be non-existent. Some of the highest paid technical experts and officials may invest more in the state loan than is strictly necessary to avoid the reproach of anti-social leanings. The motive in exceeding the minimum is in most cases more the desire to curry favour with the Party Bosses than to provide for the future. The interest, 8 per cent per annum, paid to holders of state loan is high according to capitalist notions, but that it provides little inducement for voluntary saving is shown by the preference shown for the premium tranche of the loan. It is evidently the opinion of the ordinary citizen that if he must lend to the State it is

better to take the chance of winning a big lump sum than enjoy the certainty of a regular but small addition to his income.

The Soviet State undertakes to provide for everyone incapacitated by age or physical defects from earning their own living. The fear of an indigent old age does not promote saving, and it is worth noting that this aspect is not mentioned in the loan propaganda. This is based partly on an appeal to the patriotic or party spirit of the loyal citizen and partly on the chance of winning a prize and buying a motor bicycle or having a long holiday in the Caucasus. It is definitely part of the Socialist system not to encourage any form of individualism, and saving for old age would certainly be open to that reproach.

If the bourgeois anxiety to safeguard old age is but a feeble motive for saving under the Soviet system, the other great capitalist urge to save, namely, the desire to accumulate the means of production, is even less applicable to the Socialist State, which takes very good care that private initiative shall be effectually discouraged by taxation when even more forcible deterrents are not used. It is conceivable that a well-paid Soviet citizen might save up with a view to buying a Russian Ford car or building himself a house. In theory both are possible, but it would be unthinkable that a private car-owner should employ it as a taxi or a house-owner let rooms. Somewhat paradoxically the Soviet State, while encouraging and compelling saving to the utmost, has removed practically all the temptation to save.¹

¹ Though derationing of bread was only introduced at the beginning of 1935, it seems at once to have given rise to a certain revival of private enterprise. If this develops in spite of the repressive action of the Government, it may have an important effect on "saving" and price formations.

§ 3. INDUSTRIAL PROFITS AND SAVING

In the previous chapter on Prices we saw that the wholesale prices of manufactured goods are fixed at a level calculated to cover production costs plus a planned percentage of profit and amortisation. There is no sharp distinction between profits and amortisation and they are usually lumped together under the head of "accumulations". The amount by which the total revenue of an enterprise exceeds total expenditure goes partly to the State as a budgetary contribution, the balance being available for capital replacements and repairs and for capital improvements and extensions. Assuming that an enterprise has fulfilled its plan and realised its planned accumulations, it pays a comparatively small percentage of its net profits to the State. This may be compared to the divisible profits of a capitalist enterprise. Of the balance a part is retained by the enterprise for financing its own replacements and extensions and the rest is paid into the Prombank, where it forms part of a general pool for capital repairs and development. Theoretically that portion of industrial and commercial "accumulations" due to amortisation is not saving since it is supposed to be earmarked for repairs and replacements, but there does not appear to be a direct connection between the sums set aside for amortisation and the sums actually expended on capital repairs and replacements. It is, in fact, probable that in industry at least actual depreciation is not fully covered by amortisation appropriations from gross accumulations. According to the budget estimates for 1934 the total budgetary grants to industry amounted to R.16.6 milliard. How much of this was for capital development was not stated, but

out of R.33.4 milliard budgetary grants to national economy as a whole only R.17.8 milliard was specifically devoted to capital investment. The total sum to be spent on capital investment during the year was R.25.1 milliard, so that R.7.3 milliard had to be provided out of the accumulations of state enterprises not passing through the budget. The total planned net profit of industry, excluding amortisation, was estimated to amount to R.7 milliard, of which R.1.5 milliard was paid into the budget. This would leave some R.5.5 milliard retained industrial profits, a very small amount compared to the total sum to be spent on capital investment.

Since not much more than half the total budgetary expenditure on national economy was devoted to capital development, it seems fairly reasonable to assume that part of the balance was designed to cover capital repairs, losses, etc. As has been stated already, several of the new giant metallurgical works are operated at a loss and require an annual subsidy from the State. While this is allowed for in the financial plan, losses or even failure to realise planned accumulations, due to production costs not being reduced according to plan, must also be made good by budgetary grants at the expense of capital investment. The Soviet Government does not publish any details of the finance of industry showing total accumulations, losses, expenditure on capital repairs and replacements. It contents itself by making a bare statement of total industrial profits and the amount of total grants from the budget. As the realised figures as published are always very near the estimates, in spite of the admitted fact that planned contraction in production costs is not realised, a certain scepticism regarding published Soviet figures

is excusable. But it is immaterial, or rather it does not affect the theory and practice of saving under the Soviet system, whether and to what extent industry as a whole provides for its development out of its own profits. If the bulk of the money for national development is provided by the turnover tax (about 88 per cent in 1934), it simply means that the State has collected trading profits instead of allowing the producers of the goods to benefit directly by the high selling prices. The reason for this is, of course, to deny individual trusts and enterprises initiative that they might use contrary to the Plan. So long as the Government holds the purse-strings it can control the country's economy fairly effectively, but if anything like free markets and competition were allowed unplanned developments would soon become apparent.

§ 4. THE MONETARY ASPECT OF SAVING

In all capitalist economics savings are thought of and spoken of in terms of money. Under the Soviet system savings are also denominated in money, but are the two cases similar? In any type of economy money as a concrete substance has no value in itself. It is a token which can be exchanged for goods. If an individual or a corporation in a capitalist State saves money it means that he (or it) has during the period of saving given, or better advanced against eventual repayment with interest, more to society than society has given him (or it). It does not make any difference whether the saver is an artisan, a small tradesman, an industrialist or a rentier; he or an ancestor has done work or made goods for the benefit of the community and the community has acknowledged this by paying money,

that is by giving its benefactor a claim on the community for what is mutually considered a fair equivalent. These claims may accumulate and be lent at a price to a third party who wants capital. If a large capitalist industrial concern wants to expand, it issues shares or a loan to which people subscribe their savings, that is to say, they give the entrepreneur concern the right to use their claims on the community for goods and services. Thus the new workers engaged in producing the new machinery and the new buildings and all the other people affected by the expansion of the works can be paid or given the right to consume the food and other things the savers, *i.e.* the new shareholders and debenture-holders, have gone without.

Of course all this is extremely primitive and elementary, but it is in elementary principles that the Soviet system must be compared with the capitalist system. One of the first differences one perceives in the Soviet system is the absence of a section of the community receiving incomes much in excess of their mere living requirements. There are extremely few citizens who possess a monetary income or claims on the community for more than they and their dependants can comfortably consume. Even if an individual were in receipt of a really big monetary income he could not spend it in the same way as a rich man in a capitalist country. He could not own a big house and grounds with servants, nor a private yacht, etc. At the most he could spend his money on expensive food, on a fur coat, a piano, etc., and spend a holiday at the best available hotels in the Crimea or Caucasus. For all these things he must pay an extravagant price, far more than they cost the State to provide. If he lends the money to the State, instead of buying expensive

Soviet system there is an immediate use for all material. Any enterprise that holds unnecessarily large stocks of anything is depriving some other enterprise of something urgently wanted. Some factory, we will imagine, has in some way succeeded in getting hold of a quantity of window glass and, because glass is a commodity whose supply is not fully up to demand, it is a good thing to have a fairly large amount on the premises. Another factory which has been unlucky in getting its indents honoured may have to carry on for some weeks with broken windows. Obviously it is to the general advantage to distribute available stocks where they are most needed. But the very reason which makes this desirable—that is, the shortage of supply—is a cause of hoarding.¹ The idea of keeping internal resources as liquid as possible in order to reduce to a minimum the amount of borrowed resources on which interest must be paid would not appeal to a Soviet factory manager. As a matter of fact, interest in the conditions of Soviet planned economy is different in many ways from capitalist interest. But it can be assumed that interest as a controlling factor in Soviet credit is of little, if any, importance.

§ 4. TURNOVER CAPITAL CONVERTED INTO FIXED ASSETS

Following Mr. J. M. Keynes' definition, we may think of liquid capital as a stock of goods at the commence-

¹ Because of the maldistribution of material and goods, enterprises are not infrequently prepared to pay a high premium for some essential commodity which cannot be procured through the ordinary channels. Other enterprises may have a surplus stock of this commodity, which they hold as a hidden reserve but are prepared to sell at a sufficient premium. There are a certain number of private individuals who make a very good income by acting as brokers between potential sellers and

something that could be obtained and consumed now with the intention of enjoying it at a later time. In the Soviet system money is necessary for buying the necessities of life, housing, food and clothing, but owing to the shortage of these things nobody can obtain more than a certain limited quantity except at very high prices. Every wage-earner entitled to buy goods at normal prices requires to spend a certain more or less definite sum of money on his day-to-day living expenses, that is on rent, light, heating, food rations plus a little extra sugar, butter, etc., of which only very small amounts are included in the ration, and clothing. If, for the sake of argument, a Soviet citizen has an income of R.500 a month of which R.200 are required to cover his normal cost of living, he has R.300 to spend on luxuries such as imported clothing, expensive food, amusement and so on. He would only feel the pinch if his net income, after subscribing his quota to the state loan, were reduced below his normal cost of living. There is, of course, the other side of the picture—savings are just as valueless as surplus income. There is a faint prospect, but no certainty, that the Soviet citizen who saves up enough roubles may one day be able to buy and own property. In short, the average Russian worker's consumption is not so much restricted or lowered by the proportion of his money income saved and handed back to the State as by the amount of consumption goods made available by the State. His claim on the State amounts on the average to about $\frac{1}{16}$ millionth of the total flow of consumption goods, quite irrespective of what he has to pay for it.

If this be the correct way of viewing the matter, why should the Soviet Government go to all the trouble of paying out wages and salaries only to take quite a

considerable portion back again? The answer is, because if it did not collect taxes and loans, the rouble would be rather less real money than it is.

We may assume that the money cost or value of all goods produced by human effort in Russia is equal to the total amount of wage and salary payments and the payments made to the peasants, fishermen, trappers, etc., for the grain, fish, furs, etc., delivered or sold to the State. This would not apply to a capitalist State where rents, royalties and all sorts of other payments must be considered. However, in Russia the following formula must be approximately true:

If W = total money payments to workers,
 peasants, etc.,
 then W = total money income of the population
 and also = cost value of total production;
 if S = "savings" or the value of total capital
 goods produced,
 then $W - S$ = the value of consumption goods produced.

If consumption goods were sold at actual cost price to the consumers, these would only be called upon to pay that proportion of their income represented by the fraction $\frac{W - S}{W}$, and the rest would accumulate in the form of worthless paper. If the State pays the workers money wages it must recover that part of the total wages paid out in the production of capital goods and in administering the country, providing social services and so on. It does not really matter how the surplus purchasing power is abstracted from the population, but in actual fact the greater part is recovered by increasing the price of consumption goods. The

following figures relating to 1933 give some idea of the manner in which "saving" is enforced by the Soviet Government:

	Milliards of Roubles
(1) Total national income (calculated according to the price level of 1926-27)	50
(Since prices have risen considerably in the meantime, the national income at current prices would be higher. In 1933 wages and salaries to all employés and workers engaged in national enterprises amounted to R.34 milliard. To arrive at the total monetary income of the population the salaries of government officials, army and naval officers, etc., and the payments made to the peasants for their produce must be added. There are no figures giving any idea of the total volume of these payments.)	
(2) Mobilisation of the resources of the people	9
(This includes direct taxation, loan subscriptions and savings bank deposits.)	
(3) Turnover tax on consumption goods	17
(4) Revenue from "commercial" trade	3
(I.e. the difference between the normal prices of retail goods and the higher prices charged in the "commercial" shops.)	
(5) Value of total retail turnover	43
(6) Value of production of light industry	17
(Light industry includes manufactured consumption goods and the products of the so-called food industries, e.g. bakeries, canneries, sugar factories, etc. The value is calculated according to the price level of 1926-27.)	

Out of its total purchasing power or monetary income the population spent R.43 milliard on consumption goods, R.9 milliard was returned to the State as taxation, loan subscription and savings bank deposits,

and an unknown amount was spent on rent, travelling, municipal services (lighting, heating, etc.) and other sundries. It is clear that the cost to the State of producing consumption goods was less than half the price actually paid by the consumer. The sums paid for services must also have been considerably in excess of actual cost. The above figures show why such enormous "profits" must be made on the sale of goods and services to the population. The total national income amounted to more than R.50 milliard, while the value on the same basis of calculation of consumption goods was only R.17 milliard. If only about one-third of national income was in consumable form, the total monetary income of the people, even allowing for direct taxation and sundry other expenditure, was far in excess of the total production cost of available goods. Therefore prices must be raised far above cost level to adjust purchasing power to supply.

Compared to the sums taken from the people by price manipulation, the amount taken directly by taxation and loans is comparatively small. There appears no particular reason for resorting to direct taxation and issuing loans when popular consumption can be equally well restrained by raising prices, but no doubt there are psychological considerations which make the Government unwilling to let these methods of raising revenue fall into abeyance. Moreover, with the gradual disappearance of rationing the importance of discriminatory taxation for political ends is enhanced:

§ 5. THE STATE'S USE OF MONETARY SAVINGS

So far we have seen how the Government enforces saving or abstinence on the population. The difference

between the nation's consumption and its production is represented by the money "savings" collected in one way or another from the people. Part of the national budget revenue is expended on consumption. This is not saving and therefore does not reduce the total consumption of the nation. That part of the population engaged in the actual production of commodities must obviously surrender part of what they produce for the maintenance of the non-producers, such as the defence force, police, teachers and so on. But we are now dealing with that part of the national production designed for capital investment. The workers engaged in capital production (this includes buildings for industrial purposes, canals, railways, etc., as well as heavy industry producing iron, steel, factory machinery, power plants, etc.) must be paid wages entitling them to a share in the output of consumption goods and the money must be provided in one way or another out of the national income. The workers engaged in producing capital goods are, of course, paid by the enterprises for whom they work and the money is derived from the sale of the enterprises' production, iron, steel, building material, etc., or from payment received by the enterprises for their services as contractors in providing labour for building, etc. The money to pay for these goods and services, assuming that they are employed in capital development and construction and not to make good wastage and depreciation, is provided by the long-term credit banks from funds supplied by budgetary grants and by the obligatory deposits by enterprises of a percentage of their accumulations. (These "deposits" are more properly levies, since they neither earn interest nor are repayable.) Whatever the origin of these investment funds they must ultimately

be paid by the people in their capacity as consumers either in the form of direct taxation or in addition to the prices they pay for their consumption goods.

We can now try to compare Soviet "saving" with capitalist "saving" and see whether there are any fundamental differences between the two systems. It is also becoming plain why the Soviet Government found it expedient, if not necessary, to introduce money savings at all; why they did not simply say, "This year we will build so many new factories and produce so many tons of iron and steel, so many millions of bricks", etc., without converting these things into terms of money.

In a capitalist State there is always a certain though varying sum of money seeking investment. This money consists, as we have already seen, of unenforced claims on the community's material income, that is, on the available goods and services. These claims can be transferred and converted from one thing into another. For example, if one man saves part of his income and by doing so refrains from buying a motor car, employing servants, eating expensive food or accumulating a large wardrobe, he may lend the money to another man who may build a house, or he may buy shares in some enterprise which will use his money, say, for buying machinery. He can also keep the money dormant or idle for a time and bring it out into activity again later on. If all the people in the country suddenly decided to cut down their consumption of the same sort of thing, say clothes, and invest the resulting saving, say in breweries, there would obviously be considerable confusion in the tailoring and brewing industries till they had adapted themselves to the new conditions. But though there may be fashions in investment, changes come about gradually and sudden

dislocations do not, in practice, occur. Money can buy only those things that exist; but the free movement of prices in the market (including the price of the use of savings, *i.e.* interest) is constantly tending to ensure that just those things are brought into existence which the people with incomes to spend are prepared to buy; and when occasionally demand and supply do get out of harmony, a comparatively small price fluctuation soon corrects the error. There is never, except there be a war, any likelihood in this country of such a sudden increase in capital construction as would overtax the country's output capacity of iron, steel, cement, etc. Therefore if a new enterprise is formed with a given capital it can usually rely on being able to obtain all the material and labour it requires at approximately ruling prices.

It is not the same under the Soviet system. We will suppose that the Soviet Government decides to create a big new manufacturing enterprise, draws up the plans, appoints the directors, gives them a cheque on the Prombank for, say, half a million roubles and tells them to get on with the job. Nothing would happen unless the Planning Commission had provided for the material and labour required. It is more or less correct to say that every ton of iron and steel, cement, bricks, etc., is earmarked for some special purpose before it is made. It would be quite impossible under the present circumstances for a new enterprise to come into the market for its requirements. Before it can start work it must be allotted a share of the total output of material and the Planning Commission must see that the requirements of the consuming enterprises can be covered by the producing enterprises. It appears, then, that the function of money savings in Soviet capital

development is not quite the same as in a capitalist economy; and further, that if planning really went so far as to adjust in detail every development scheme to the available supply of labour and material, money would be unnecessary. But it would in practice be impossible to calculate the exact output of material according to every conceivable category and type of structural goods and then produce plans for new factories, power stations, houses, etc., to correspond.

We have seen that the total amount of money savings must bear the same relation to total national income as the production of capital goods bears to total production. The Planning Commission, therefore, has a guide to the total volume of capital goods available. Supposing for the sake of argument that the "savings" in the course of the year are planned to amount to R.20 milliard, that means that the State may budget for about R.20 milliard worth of new construction. This sum is distributed among the various trusts, combines and other organisations according to the plan for national capital development, and every trust, etc., must produce plans and estimates for utilising its grant. As a matter of fact, detailed priced estimates are supposed to be drawn up for every projected new construction, and if these estimates are correct and their aggregate corresponds to the total sum of money available for capital construction, it should follow that the amount of material available will be approximately sufficient to enable the projected work to be carried out, presuming that there have been no appreciable changes in the price levels. It must, of course, be assumed that the average proportions of iron, steel, bricks, cement, etc., used in erecting buildings and of iron, steel, copper and other materials used in

producing machinery continue roughly the same, for if there were a sudden alteration involving the use, say, of a higher average proportion of metal and a lower proportion of bricks and cement, although the total value of material would correspond with the cost of new construction, there would be a shortage of the one sort of material and a surplus of the other.

In Soviet investment money seems to have more the nature of a symbol or a common denominator to facilitate the distribution of resources. It would scarcely be correct to speak of the Government or its enterprises "buying" commodities or labour in the same sense that capitalist enterprises buy their requirements. On the other hand, exchanges of goods and services are invariably settled in money, for this is essential if financial estimates and balance-sheets are to mean anything. The rouble functions as a unit of account in precisely the same way as a capitalist currency. As a measure of value it provides a unit in which values are expressed, but values are arbitrary. When, therefore, the Soviet Government announces an investment programme of so many milliard roubles for the year, this does not represent an absolute value in terms of any standard, but that a proportion of the national production equal to the proportion between the amount of the investment plan and the total national income is being devoted to capital development and not to current consumption.

Note.—The abolition of all rationing and artificial restriction of consumption after 1st January 1936 modified the situation in some respects and necessitates some revision of the argument in the foregoing sections of this chapter. So long as rationing was in force, when the Government took part of a high personal income in taxa-

tion and used the money for paying the wages of ordinary workers, it increased the effective demand of the latter without making a corresponding reduction in the consumption of the tax-payer; the net result was an increase in the effective demand for consumption goods, which was not reflected in a rise in the prices of rationed goods. After 1st January the flow of consumption goods was, on the whole, sufficient to cover demand at the prices fixed by the Government, and it became theoretically possible for a private individual to obtain as much of any commodity as he could afford at the current price. The former extreme differences in the purchasing power of different units in a private income and the inequality in the purchasing power of roubles in the hands of differently privileged consumers disappeared. For practical purposes, therefore, every rouble taken by the Government in taxation has approximately the same purchasing power when redistributed in wages and salaries as it would have had in the hands of the tax-payer. While taxation still brought about a certain redistribution of the national income it no longer affected the total demand for consumers' goods; and money "savings", that is, revenue devoted to capital investment, required a more precise and definite value than before derationing.

§ 6. CURRENT SAVINGS AND ACCUMULATION OF RESERVES

When the Soviet Government talks of national "saving" it does not mean quite the same thing as capitalist saving. The capitalist individual or enterprise reckons up his savings at the end of the year, and the amount by which income exceeds expenditure is thought of as savings. Such savings cannot be spent until they exist. Thus, if an entrepreneur decides to extend his plant or, to take a simple and primitive example, if a family butcher decides to buy a delivery

van out of profits, he must wait until he has accumulated the price of the van by not spending all his current income. Take another instance, supposing a municipality plans a scheme of improvement to finance which it issues a loan, it cannot begin using the money before the subscribers have paid up. It is, however, possible to anticipate savings or the yield of a loan by temporarily borrowing from a bank.

The Soviet Government does not wait for savings to accumulate, it anticipates them. In effect the economic heads say: this year we will build so many kilometres of railway, so many dwelling-houses, grain elevators, etc., and our machinery works must provide so much plant for this and the other new factory. To do this we must employ so much labour which will require so many millions of roubles in wages. The money will be found by the budget and by the long-term credit banks, and according to the finance plan so many roubles will come in every month through taxation, the accumulations of state enterprises, subscriptions to the state loan and so on. It seems pretty clear that current capital expenditure is met by current revenue and there is no question of real saving at all. Can we test this theory and see whether it really fits the facts?

Every year the budget estimates provide for a certain sum to be placed to the reserve. We will suppose that in 1934 R.1.5 milliard of budget revenue was "saved" and placed to the reserve account of the State. Now this should be "saving" in the real sense of the word, but what does it in fact represent? The Treasury presumably has R.1.5 milliard to its credit at the Gosbank, which sum has come out of other current accounts and out of circulation. In other words, so long as this money is not returned to a state of

activity, there has been some deflation, not of course to an appreciable degree. In a capitalist country a government reserve in the same sort of conditions might be used to buy back government debt or might be invested in the national economy. For example, for several years prior to the depression Poland had an annual budget surplus which was largely invested in the bonds of the state banks, representing loans to national economic undertakings and private entrepreneurs. When the budget began to show a deficit, the Treasury was able to mobilise its reserves and use them for current expenditure.

Can the Soviet Government do the same thing? The answer appears to be no. The Soviet budget surplus cannot be lent out to state enterprises under different conditions from the ordinary budgetary grants. If it is handed out it must immediately cease to be a reserve; alternatively all budget grants to state enterprises form a treasury reserve, but not a liquid one.

The whole principle of a reserve is to give the future power to buy something, not necessarily concrete goods. If the Soviet Government has a reserve at the Gosbank, could it use it in an emergency, say if war broke out and it wanted tanks and aeroplanes? A rouble reserve at the Gosbank would be completely useless for buying anything abroad. Internally it would seem unnecessary if not completely useless. For all the industries which make tanks and aeroplanes belong to the State. In the event of war the production of tractors and civilian aeroplanes would be curtailed or discontinued and full capacity devoted to war planes and tanks, but since these industries in any case are working pretty well at full capacity their total output would not be increased, only changed in character. In peace-time their tractors,

etc., are sold to other state enterprises; in war-time their tanks would be sold direct to the Government; but ultimately the output of one state enterprise is always sold or handed over to the State in one way or another and there would be no object in bringing dormant money into circulation.

The conclusion seems inevitable that a treasury reserve held in the form of paper roubles has no meaning in Soviet economy. The only reserve that would be of any use would be something tangible. If the Soviet Government invested its budget surplus in laying up a store of gold there would obviously be some sense in it. It might, of course, lay up a material reserve of iron, steel or grain, but there would be little sense in this because such commodities are in great demand and their consumption now tends directly or indirectly to increase output in the immediate future.

It will be pointed out that in a capitalist system a reserve fund as such is not tangible goods. That it can be converted into goods at any time is merely due to the fact that there are goods to be bought from others, and if we compare the Soviet system with an immense capitalist combine we get a better idea of the true situation. It seems fairly obvious that if, say, Imperial Chemicals held a large cash reserve which could be used only within the circle of its own subsidiaries, the money could not as a matter of course be converted at a moment's notice into any of its multitudinous products. But there is quite another state of affairs when we come to consider a capitalist State in which there are a multitude of separate individual enterprises. Reserve funds belonging either to private enterprise or the State are normally invested or lent out. When the time comes for the owner of the fund to use it

himself he demands it back from the borrower, and the net effect is a change in the employment of the equivalent purchasing power, but not in the total volume of purchasing power. If a reserve is kept idle, that is, hoarded, the effect is to reduce the circulation of purchasing medium and to reduce economic activity. When the reserve is put back into circulation it will tend to stimulate economic activity. Normally in a rich country there is a proportion of unemployed labour and unemployed machinery; in short, unemployed productive capacity. An increase in purchasing medium like an injection of additional credit will bring some of the idle capacity into employment. If the increase in circulation or credit is excessive, prices will rise. Since in Russia practically all production capacity is fully employed owing to the shortage of goods, an increase in currency circulation, if the Soviet Government suddenly decided to use its reserves, would result only in a rise of prices. The difference between the functions of money and the way in which it operates in relation to "saving" in capitalist and Soviet economics may be summarised as follows: In a capitalist economy money savings represent the power of acquiring from others or disposing of an equivalent value of goods or services. The savings of a private Soviet citizen in a more limited degree give him the same sort of power, but national savings are merely a measure of the excess of production over current consumption which the State can devote to capital investment. That is to say, money savings do not give the State the power of buying goods and services, but only indicate the proportion of current production available for adding to capital. Under the Soviet system, private ownership of capital being impossible and all production

being directed from the centre, a holding of cash has no use except to purchase current output; whereas in capitalist countries cash may be held for future investment. It follows that under the Soviet system the decisions determining saving and investment are taken by the same people and not by two different sets of people influenced by different motives and not paying much attention to each other. For this reason the fluctuations in employment, production and prices which are caused in capitalist society by disequilibrium between saving and investment should not in theory happen in the Soviet Union. If, nevertheless, fluctuations in the volume of economic activity occur, Russian experience may throw a new light upon the general problem of unemployment.

§ 7. PRIVATE SAVINGS

This chapter on savings would not be complete without some reference to the savings of the individual citizen. Every state employé, wage-earner and most peasants have to subscribe to the state loan. They can buy interest-bearing bonds or premium bonds, and the latter are more popular. It can be stated at once that the ordinary subscriber is uninfluenced by the notion of accumulating income-yielding capital, and that very few think of their bonds as representing a store of purchasing power set aside against an emergency. In any case the bonds cannot be sold except with the permission of the authorities, rarely given.

Probably few citizens realise that their loan subscriptions actually do not deprive them of the enjoyment of the equivalent in goods or service. If no loan were issued, the people as a whole would have more

money, but prices would be higher and there would be no increase in the supply of consumption goods.

The loan, issued in annual tranches, is repayable within ten years. The time must come when the annual service equals the annual subscription. Already in 1934 it was nearly 50 per cent of the annual issue, but the real cost of the annual service as distinct from the money cost is relatively if not absolutely declining. The money paid out costs the State very nearly nothing; it is the goods which the money will buy that represent the real cost, and as prices have steadily risen relatively less goods have had to be provided. No price indices have been issued by the Soviet Statistical Bureau for several years, but it is probably near the mark if we take it that a rouble in retail trade in 1935 bought not more than half what it bought in 1930. In spite of the Government's promises to lower prices by 1937, the only perceptible trend was a rise. In these circumstances private savings are largely illusory and it is scarcely surprising that subscriptions have to be obtained under pressure.

CHAPTER XVI

TURNOVER CAPITAL

§ 1. DEFINITION OF TURNOVER CAPITAL

SOVIET economists prefer the term "Turnover" capital to "Working" capital. Theoretically every Soviet industrial and trading enterprise should possess sufficient liquid resources of its own in the form of money, stocks of material, goods, etc., to enable it to maintain its normal activity or rate of turnover without drawing on credit. The money value of the turnover capital so defined is the enterprise's "normative". In trading enterprise, of course, the bulk of the "normative" is represented by stocks of merchandise.

Every enterprise has a planned rate of turnover. A manufacturing enterprise should not only convert raw material into the finished product in a definite period, but each successive manufacturing process should occupy a fixed period, and there should be a more or less fixed quantity of finished goods ready and waiting despatch. In a planned economy there is no manufacturing on speculation. All goods are manufactured as a result of the plan of production and consumption.

Wholesale and retail distributing enterprises have a fixed average turnover period for their stock. This average period is calculated on the turnover period of every sort of commodity. For perishable foodstuffs it is almost a matter of hours, while for non-perishable and more or less luxury goods it may be a week or two.

Thus in theory there is an even, steady flow of raw material into, and a corresponding flow of finished goods out of, manufacturing enterprises, and an even and steady flow of merchandise into and out of the trading or distributing system. In practice the economic machine does not work so smoothly, but at the moment we are studying the function and theory of Soviet money, and it would only complicate and confuse our investigations to try to combine theory with explanations of what happens when plan and realisation fail to agree.

It is plain that if the activity of an enterprise were as regular as clockwork and the prices paid for material and labour and the prices received for the finished product were constant, its "normative" could be exactly calculated and would be represented by the value of material, partly and wholly finished goods in stock together with cash in hand and net balance at the bank, for fluctuations in stocks of material and goods would be offset by fluctuations in its cash balances.

It may have been noticed that no mention of wages has been made. Obviously wages are turned over in the same way as material. But we shall see on reflection that wages are entirely included in the value of partly and wholly finished products. The turnover capital includes the value of prescribed stocks of goods in various stages of completion, and the amount by which the original cost of the raw material has been increased is largely due to the cost of the labour employed. It is no less true that the value of finished goods includes the value of the fuel and other auxiliary material consumed in their manufacture. But a factory must hold certain stocks of such material. It cannot carry on from hand to mouth. Therefore it is plain that turnover

capital must include the value of the average unconsumed stocks or reserves of auxiliary material, while the value of the material when consumed is included in the value of the partly and wholly finished product.

As turnover capital there is this difference between material and labour: material is bought before it is consumed, hence stocks of material are temporarily idle capital. But labour is paid after it has performed its job. We can put it this way: a factory is the creditor of its stocks of material until they begin to be used up in the manufacturing process, but a factory is always in debt to its labour. In order to make this perfectly clear it should be explained that the rule in Soviet industry is to pay the employées twice a month, but pay-day is always a few days after the end of the earning period. For instance, wages due for the work done between the 1st and 15th of the month would be paid out about the 20th.

§ 2. TURNOVER CAPITAL AND MONEY COST

In the capitalist system the demand for working capital fluctuates. The most important cause of fluctuations is changes in economic activity. At a time of depression manufacturers endeavour to hold smaller stocks of material and finished products because with falling prices the value of working capital in kind depreciates. On the contrary, in a boom, more particularly at its beginning, the manufacturer lays in a large stock of material because he foresees a rise of price. There are of course many other factors which influence the demand for working capital in the capitalist world. But all we are trying to do is to illustrate the difference

between planned economy and private enterprise. Under planning there are no slumps and booms and no fortuitous changes in the rate and intensity of production, therefore the need for turnover capital remains steady, or rather increases at a regular prescribed rate. If a Soviet enterprise possesses its proper "normative" it should be able to cover its expanding needs out of its own profits. That is, assuming it works according to plan and makes its planned profits. Theoretically a Soviet enterprise, when once it has been endowed with or has accumulated by its own efforts its planned "normative", should never have to apply to the bank for credit except to cover seasonal and other abnormal requirements.

Capitalist economists distinguish between working capital expressed in terms of money and real or material working capital. Obviously, if the cost of labour goes up and the prices of material rise, a capitalist enterprise will require a larger amount of capital, measured in money, to be embodied in working capital, even though there be no increase in the amount of labour employed and the amount of material consumed. In the Soviet system prices of material are fixed by the Plan while increases of wages are supposed to correspond more or less to the increased productivity of labour. Theoretically, therefore, a given quantity of material working capital will have a constant value in money. On 1st January 1935 bread cards were abolished and a single price fixed at which bread was in future to be sold without restriction. This single price was much higher than the old ration price, and to compensate the workers for the increased cost of living wages were increased all round. In effect this meant a devaluation of the rouble and a sudden increase in the cost of

turnover capital. The way in which the necessary adjustments were made seems best dealt with in a separate section. In the meanwhile, we will continue to study the theory on the assumption that practice corresponds.

§ 3. PLANNED DISTRIBUTION OF TURNOVER CAPITAL

The Soviet State rigidly keeps to itself all decisions connected with the creation of new enterprises. The plan of economic development would be ineffectual if individual industries or corporations could accumulate liquid assets and employ them as they liked in creating new means of production. Therefore the State does not allow any organisation to accumulate resources in excess of what it requires to maintain its planned rate of development. Surplus assets, or, as the Soviet economists call it, "internal resources", occasionally are discovered in the possession of individual enterprises. They may consist of surplus stocks of raw or auxiliary material, building material, or even buildings. Any enterprise possessing unemployed internal resources, that is, surplus material or property, is ordered immediately to mobilise or sell its surplus and place the proceeds to the credit of its turnover capital. Since comparatively few enterprises, in fact, possess their proper "normative" and are permanently in debt to the bank, the mobilisation of surplus resources is used to repay bank credit. No capitalist entrepreneur would hold surplus stocks unnecessarily, because if his own capital is immobilised he must pay interest on money borrowed to take its place. But it is quite conceivable that he would consider it advisable under certain conditions to hold rather large stocks of material or even to keep possession of an unused building. Under the

Soviet system there is an immediate use for all material. Any enterprise that holds unnecessarily large stocks of anything is depriving some other enterprise of something urgently wanted. Some factory, we will imagine, has in some way succeeded in getting hold of a quantity of window glass and, because glass is a commodity whose supply is not fully up to demand, it is a good thing to have a fairly large amount on the premises. Another factory which has been unlucky in getting its orders honoured may have to carry on for some weeks with broken windows. Obviously it is to the general advantage to distribute available stocks where they are most needed. But the very reason which makes this desirable—that is, the shortage of supply—is a cause of hoarding.¹ The idea of keeping internal resources as liquid as possible in order to reduce to a minimum the amount of borrowed resources on which interest must be paid would not appeal to a Soviet factory manager. As a matter of fact, interest in the conditions of Soviet planned economy is different in many ways from capitalist interest. But it can be assumed that interest as a controlling factor in Soviet credit is of little, if any, importance.

§ 4. TURNOVER CAPITAL CONVERTED INTO FIXED ASSETS

Following Mr. J. M. Keynes' definition, we may think of liquid capital as a stock of goods at the commence-

¹ Because of the maldistribution of material and goods, enterprises are not infrequently prepared to pay a high premium for some essential commodity which cannot be procured through the ordinary channels. Other enterprises may have a surplus stock of this commodity, which they hold as a hidden reserve but are prepared to sell at a sufficient premium. There are a certain number of private individuals who make a very good income by acting as brokers between potential sellers and

ment of any period of production. In a state of perfectly balanced equilibrium between production and consumption there is no need for liquid capital in this sense. An enterprise in full operation is continuously feeding part of the flow of available income back into the machinery of production. But in the creation of a new enterprise liquid capital must be consumed or converted into fixed capital. When the Soviet Government started to build its industrial giants—such as the power station at Dnepropetrovsk on the Dnieper and the metallurgical works at Magnitogorsk in the Urals—it undertook to feed, house and clothe an army of workers whose labour would not result in any output of power or iron and steel for several years. The consumption goods consumed by this labour were therefore taken out of the flow of available goods without returning any equivalent at the time. It has been generally admitted by the Soviet authorities that the cost of constructing many, probably a majority, of the new industrial enterprises begun under the Five-Year Plan materially exceeded the original estimates. It seems almost certain that in so far as genuine savings or budget investment funds were insufficient to cover actual expenditure on capital investment, short-term bank credit was improperly drawn upon and inevitably became frozen or immobilised. This occurred not only in respect of new enterprises—many existing undertakings already in full operation took advantage of a certain slackness in the credit system following the credit reform of 1930 to make unplanned additions to their fixed assets at the cost of the bank. The result of

buyers. All this is of course quite illegal; buyer, seller and broker being liable to all sorts of penalties. But the system is winked at by the authorities because it helps to correct the deficiencies of the Plan.

all this was a large increase in the currency circulation and in the indebtedness of the national economy to the State Bank. The following are the figures covering this period:

	Circulation of Bank and Treasury Notes	
	R. million	
January 1930		2565
September 1931		4610
March 1932		5131

	Gosbank Credits	
	Gross	Net
	R. million	R. million
1st January 1930	4,639	3770
1st January 1932	10,396	6191

This expansion of currency and credit was proportionately far greater than the increase in the country's material production. The value of the total output of large-scale industry increased from R.25.8 milliard in 1930 to R.36.8 milliard in 1932. This invites the conclusion that a great deal of short-term bank credit became frozen and that the Gosbank and Treasury printed notes to cover the "losses". But whether these "losses" were losses in the true sense of the word or not is not such an easy question to answer.

In a capitalist economic system losses may be particular or general if we can use these words to describe (a) the loss of an individual, which is not a loss to the community because there is an equal gain to somebody else; (b) a loss which, because it is caused by the absolute destruction of material, is a general loss to the community. It is, however, immaterial to the creditor of a bankrupt whether his losses come into

category (a) or (b). But in the Soviet system the losses of a single enterprise are only regrettable if due to the absolute destruction of material. Book losses due to ill-adjusted prices do not mean a loss to the community. In fact, prices of certain commodities are sometimes deliberately fixed at a level which inevitably involves a book loss to the manufacturing enterprise.

The Gosbank's "losses" or the immobilisation of its credit were usually reflected in clients' losses of liquid resources, in other words the "loss" or wastage in some way or another of turnover capital, but not necessarily the destruction of material. In many cases turnover capital was converted into fixed capital and in other cases was converted into an accumulation of liquid assets. In neither of these cases could one say that there had been a definite loss, though doubtless production was prejudiced by the hoarding of stocks of material and by diverting material and labour from producing goods for current consumption to creating fixed assets. So far as the bank was concerned, its short-term credit had been used to finance long-term investment or hoarding. If the bank were to replace its immobilised credit by creating fresh credit and printing more notes, symptoms of inflation might be expected to appear, and in fact this is what happened, for prices on the open market rose rapidly. Some capitalist economists may explain this as a monetary disease, but in Soviet economy the monetary aspect is a symptom, not the disease itself. It is clear that the conversion of turnover capital into fixed or liquid hoarded capital reduces proportionately the flow of current production of consumption goods. This is borne out by Soviet statistics, which show that from 1926 to 1929 the annual increases in production of heavy industry and light

industry were about equal. In 1930, however, heavy industry increased production by 41 per cent against the 20 per cent of light industry, in 1931 the percentages were 33 and 16, and in 1932, 18 and 9. Between 1929 and 1932 the value of total industrial production increased by 42 per cent, while that of light industry increased by only 27 per cent. The national income, employment and purchasing power of the people expanded much more rapidly than the supply of consumption goods, the price of which naturally rose. It may be that prices would not have risen as they did had there been no inflationary expansion of the currency, but any attempt to prevent the volume of currency in circulation from rising could only have been successful if wages and salaries had been drastically cut. In 1930 the total number of wage and salary earners was 14.5 million, in 1932 22.0 million, and the national pay-roll increased from R.13.6 milliard to R.32.7 milliard. There was, of course, no comparable increase in the volume of available consumption goods. But, supposing for a moment that wages had been reduced, a proportionate reduction in manufacturing costs would have followed because labour is the only factor in production when there is no remuneration of capital, and the purchasing power of the people would have been in about the same relation to commodity prices as before. Demand would have had to be artificially checked by imposing a turnover tax on retail trade or by rationing in just the same way as was actually done: Put in a nutshell, the situation was that the workers had to give more work in exchange for the necessities of life, and no amount of juggling with currency circulation and prices could alter this.

If the credit reform made it possible for industrial

enterprises improperly to convert a portion of their liquid assets into fixed assets, the industrial plan did the same thing deliberately. If we regard the whole Soviet economy as one gigantic combine it is easy to appreciate the fact that all consumption goods are really turnover capital. It was explained in a previous section of this chapter that the wages of labour were included in the turnover "normatives" in the form of the extra value of manufactured goods over that of the original raw material. Now as far as the individual enterprise is concerned, wages are a money cost, but the money distributed as wages is really only documentary evidence that the wage-earner has a claim on the State for the necessities of life. A farmer does not pay wages to his horses and cows for the work they do and the milk they give; but he must feed them, and their fodder is part of his turnover capital. Hay, oats and roots are consumed, but not lost because they are converted through various stages either into similar products next year or into something of equal value. Now, if the farmer chose to use his horses for hauling bricks and timber to build new barns and sold his cows' milk to buy nails, window glass and so on, he would be converting turnover capital into fixed capital, and this is a very good illustration of what the Soviet Government did and is still doing. If it be necessary to be more explicit, it may be put as follows: an increasing proportion of the output of food, clothing, household utensils, etc., was used to support the labour engaged in building power stations, erecting factories and so on; in other words, fixed assets. The amount of goods consumed by these workers was immobilised or converted into fixed capital. Had it been consumed by workers producing food, textiles, clothing and so on it would have remained

liquid. But the flow of current output was, by the decision of the Government, directed more towards investment and less towards consumption. Now this should have been accompanied by a corresponding saving on the part of the whole body of consumers if price levels were to remain steady, but the Soviet economists subscribed to an extraordinary fallacy. They asserted (it is difficult to credit them with believing) that as long as the value of the State's *fixed assets* together with circulating assets covered the volume of currency in circulation, the rouble would retain its purchasing power. They energetically repudiated the charge of inflation and expressed no apprehension at all over the rapid expansion of the currency circulation. It is very probable that never in the world's economic history has there been such disharmony between material investment and monetary saving. The natural consequence was a rapid rise in the price level, or since actual prices were arbitrarily fixed, an increasing volume of unexpendable currency in the pockets of the population. In view of all the circumstances it is fair to conclude that the "losses" sustained by the Gosbank during the period of irresponsible credit were not always losses in the absolute sense, but were often only the conversion of liquid assets into fixed assets.

§ 5. CIRCULATION OF WAGES AND COMMODITIES

Those enterprises which produce the necessities of life create liquid capital which, in so far as it supports the workers engaged in creating fixed assets, is being converted from a liquid into a fixed form. Now turnover capital or liquid assets somewhere or other have

a monetary counterpart, and if a portion of goods in circulation is immobilised by being converted into fixed capital, a corresponding value in currency must be saved or taken out of circulation, or the velocity of circulation must slow down or prices must be increased pending the increased output of goods resulting from the investment. If this is not done voluntarily it will simply mean that the circulation of purchasing medium will be retarded or a portion will become definitely inactive or frozen. During the period of irresponsible credit, before this principle was understood, there was an attempt to replace immobilised turnover capital by fresh money. Recourse was had to the Gosbank credit, which was freely issued only to become immobilised.

Perhaps this is not immediately apparent, so we will try to explain the process. The total working population of Russia is divided broadly into three categories: (a) the producers of raw material, (b) those engaged in converting raw material into consumers' goods and (c) those engaged in converting raw material into fixed capital. All three categories depend on the (b) workers for the necessities of life; it follows that those in (a) category producing food and material for immediate consumption or for consumption industries (cotton, leather, coal for heating and cooking and for the power needed by consumption industries and so on), and the (b) workers who convert consumption material into consumable goods, must share the results of their labour with the workers producing capital material and the (c) workers who convert this capital material into fixed assets. If all the workers could use all their wages for buying consumption goods at cost price there would be a shortage of goods, because, no matter at what level wages are fixed, the value of total national

production is roughly equal to the total volume of wages; but only a part of total production consists of available goods. Now to bring total purchasing power into equilibrium with available production, incomes must be reduced by taxation and/or prices raised by taxation in the absence of saving. If equilibrium is not reached by these means there will be surplus and unexpendable purchasing media in the pockets of the population, as in fact there was. This surplus is immobilised or frozen. Now all purchasing power goes into circulation in the form of wages paid by the State or its enterprises to the workers and in money paid to the peasants for produce. The volume of these payments depends on the rates of wages and the number of wage-earners, both of which steadily increase. If part of this money is not recovered by the State in the ordinary way of trade or through taxation or savings lent to it, but is hoarded voluntarily or compulsorily by the wage-earners, the difference must be made up by putting additional currency into circulation, for wages must be paid regularly. But because the State is the universal provider, the money it pays out can only be used for buying the goods the State supplies. The circulation of money among the people is so small that it hardly affects the position at all, so we can say that the money to all intents circulates along a single circular track: from the State to the people in return for work performed, and back from the people to the State for goods and services supplied. If the circuit is kept open money will flow round it at an even rate, but if there is an obstruction the return flow will be smaller or slower than the outflow, and if the outflow is to be kept at a constant level a supplementary stream must be injected into it. We saw above

that the turnover capital of the country as a whole is the volume of consumable goods which is regularly converted into labour, and the labour in turn reconverted into goods. Money is only the unit of account or common denominator employed in regulating and distributing the flow of turnover capital, but it cannot possibly take the place of turnover capital. In the peculiar circumstances of Soviet planned economy the circulation of money must conform to the circulation of commodities.

The exchange of goods and services between state enterprises is effected almost exclusively by book entries and therefore does not influence the volume of currency in circulation. Now the proportion of the flow of liquid assets, both in the form of material and labour, that has been transformed into fixed capital is very great; it probably exceeded 50 per cent during the most intensive industrialisation years in the first Five-Year Plan, and therefore if retail commodity prices were to be kept at their former level the wage level should have been reduced by taxation on the same scale. Probably the Government feared to tax the workers' incomes by upwards of 50 per cent of their money value, hence the need for rationing and price increases.

§ 6. CREDIT ADJUSTMENTS AFTER DERATIONING OF BREAD

On 1st January 1935 bread and most other cereal foods and fodder were derationed. The former ration price was relatively low, while prices on the free peasant market and in the "commercial" shops were two or three times the ration price. The single price

which should equalise supply and demand must be somewhere between the two former prices, and the workers who formerly had been able to buy a very large proportion of their staple food supplies against their ration cards found their cost of living materially increased. As a partial set-off against the increased cost of living industrial wages were increased about 10 per cent all round. The peasants producing industrial raw material such as cotton, flax and tobacco formerly received for every unit of cotton, etc., delivered to the State a certain quantity of grain, flour, etc., at the standard ration price. As a consequence of the de-rationing they had to buy their food supplies at the new and higher single price. This increased their cost of living, and to compensate them the State fixed higher buying prices for agricultural raw material. The increased money wages, together with the increased cost of raw material, raised the production cost of the industrial goods, and to compensate the food-growing peasants for this increase in their cost of living the prices paid for compulsory deliveries of grain, etc., were raised by 10 to 20 per cent. All this meant a definite fall in the purchasing power of the rouble and it followed that industrial and trading enterprises found the money value of their stocks of material and goods increased, in other words they secured a chance paper profit. Those enterprises in debt to the bank or any other enterprise could repay the debt with the proceeds of a smaller quantity of goods than before; conversely, creditors' claims were worth less in goods value than before. In order to mitigate the financial consequences of the sudden change in price level, a series of adjustments between the Gosbank and its clients was devised.

All industrial and trading enterprises were ordered to revalue their stocks of raw material, partly finished and completed goods and finished goods bought for consumption or trading purposes according to an official scale based on the increased cost of material and labour. This meant that the money value of turnover capital was suddenly increased by a stroke of the pen. But the turnover capital of an enterprise can be classed under three heads: (1) own planned turnover capital or "normative", (2) turnover capital borrowed from the bank, *i.e.* short-term credit, and (3) turnover capital in excess of the "normative" but not borrowed from the bank. This may consist of illegal borrowing, *i.e.* of indebtedness to supplying enterprises, arrears of wages, etc., or in rare instances of own accumulations or profits. Each class of turnover capital had to be treated individually.

(1) The profit on revaluation of an enterprise's own ("normative") turnover capital accrued, as was only natural, to the enterprise itself.

(2) The increased value of that part of the turnover capital borrowed from the bank—that is, of course, the goods and material acquired with bank credit—was added to the enterprise's liability to the bank, while the enterprise's credit quota, or planned maximum credit, was increased in accordance with the increased cost of the material and goods for the purchase of which the credit was designed. This is perfectly understandable and logical.

(3) The profit resulting from the revaluation of all goods and material in excess of the "normative" and not held on bank credit accrued to the State or local budget. The reason for this was that any turnover capital held in excess of the "normative" and

legitimate bank credit is in a sense illegal, since it is almost inevitably the result of illegal indebtedness or the improper, because unplanned, retention or employment of profits. In either case surplus material turnover capital represents a money debt or money improperly withheld from the State or some other enterprise, *e.g.* the trust. If the enterprise retained the profit on the revaluation of such turnover capital without the corresponding money liability being increased, it would obviously secure a chance profit at the expense of its creditors. The additional bank credit required to finance the same volume of turnover capital as before was provided by a budget grant to the Gosbank, thus indirectly budget funds were drawn upon to make good windfall losses incurred by economic enterprises. It was therefore quite logical that budget funds should benefit from the chance profits and not the enterprises which happened at the critical time to hold excess stocks.

The above is a concise description of the principles upon which the revaluation of goods as a consequence of bread derationing was carried out. In order to prevent enterprises from obtaining chance profits by concealing their real situation various safeguards were introduced, in particular a set formula for determining the presence of excess turnover capital and its amount. It appears on the whole that the revaluation and financial adjustments were satisfactorily carried out.

CHAPTER XVII

THE NATURE AND FUNCTIONS OF CREDIT IN SOVIET ECONOMY

§ 1. THE EARLY STAGES OF PLANNED SHORT-TERM CREDIT

IN the previous chapter we saw that the Soviet conception of turnover capital is less complex than the capitalist notion. It does not cover everything that the capitalist economist connotes by the term working capital. This is particularly noticeable in the matter of credit. In many types of capitalist enterprise allowance must be made for paying cash or at short term for raw material or merchandise and selling on credit. The amount of working capital required, whether borrowed or not, will be increased if the manufacturer or merchant gives his customers a longer average term of credit than he receives from his suppliers. In Soviet trade there is no credit between buyer and seller, all transactions being strictly for cash. Credit is a monopoly of the Gosbank, which lends money or rather gives book advances at short term to enterprises which for seasonal or other reasons are compelled temporarily to hold larger stocks or employ more labour than suffices to cover their normal activity. This may be compared to a capitalist enterprise borrowing from its bank to enable it to hold stocks or temporarily to increase production or turnover. To understand how the present system of planned turnover capital and

credit developed it is advisable to go back a few years and restate the course of events outlined in Chapter VI from the time when planning and rationing had not supplanted the open market.

During the period of the New Economic Policy trade and industry were far less rigidly controlled than after 1928. In 1924 more than half the retail trade was in private hands, and as late as 1928 about a quarter still remained outside the state and co-operative systems. Quite a considerable proportion of the output of consumption goods was also produced by private enterprise. Of course private enterprise and capital were not to be found in large-scale industry, but, as an example, a large part of the output of the nationalised textile industry was made up into clothing by private entrepreneurs employing perhaps up to a score of paid hands. Such entrepreneurs had to possess a certain amount of working capital, but they were able to supplement this by getting credit from the state manufacturing enterprise to whom they gave bills. These bills were discounted by the banks practically in the same way as in pre-War days. So far as consumption industry, retail trade and the trade in agricultural produce were concerned, the exchange of commodities was governed by open-market principles, and there was no rationing because supply and demand were automatically brought into equilibrium by the price level, which, though it tended gradually to rise, was not out of all proportion to pre-War standards. There was but little demand for the products of heavy industry except by the Government. Private enterprise did not feel sufficiently secure to acquire fixed capital such as buildings and plant. Before the first Five-Year Plan most of the product of heavy industry was in the form of railway

and building material. It was necessary first to restore the efficiency of the railways and build factories and houses for the workers before starting to manufacture machinery and equipment for the new enterprises. All this creation of fixed capital was a state concern and the money was almost entirely provided by the national budget.

Meanwhile light industry was working satisfactorily and even prospering. The existing enterprises required no subsidies nor long-term loans from the State, but financed their own capital extension out of profits. Short-term commercial credit supplied by the banking system to light industry and trade was provided by the banks' own resources and the deposits of their customers. But when universal and central planning was introduced the credit system had to be brought into line. If the whole resources of the country were to be controlled by the Plan, which provided for a very rapid development of heavy industry at the expense of light industry, it was obviously necessary to ration light industry. In open competition light industry would continue to forge ahead and heavy industry would have struggled along in the rear. The Government therefore had to concentrate in its own hands the control and distribution of turnover capital. The first step was to abolish commercial credit. Private enterprise had been outlawed and nearly exterminated, and with it disappeared the free market. In future the distribution of all goods, labour, raw material, and consequently credit, were to be governed by the Plan. The sale of goods by one enterprise to another on credit and not for cash afforded considerable scope for initiative outside the Plan, and in discounting commercial bills the Gosbank was rather a passive than an active factor in

the country's trade. But by the decree that all exchanges of goods be settled by cash payments, and by confining short-term credit to direct advances by the bank to the purchaser, a credit monopoly was created which gave the bank dictatorial powers in regulating trade and enabled it to limit the amount of credit granted to an individual borrower, as well as the total volume of credit granted to the whole national economy, to the amounts fixed by the Plan. Owing to the inexperience and inefficiency of the bank staff, the reform did not at first fulfil expectations. In practice the selling enterprise was automatically credited by the bank with the value of goods immediately they were delivered to the transport organisation, and the buyer was automatically debited at the same time. The defect of this arrangement was that it made the financial part of any transaction subordinate to the material. The paramount plan of an industrial enterprise was the material plan which determined the consumption of material and output of finished goods. The financial plan to all intents was the same thing in terms of money, and seems to have been considered as a mere check on the material plan and not to have been taken too seriously. Enterprises which should have maintained their turnover capital intact and liquid found that they could get practically an unlimited amount of credit, and because the rouble was patently a depreciating currency and had begun to lose its reputation as a stable medium of exchange, there was a certain flight into goods. Enterprises began to use their own turnover capital, and not infrequently borrowed capital as well for increasing their fixed capital or for accumulating stocks of liquid capital in the form of material and goods. In such circumstances the incentive to make

money profits was weakened, production costs rose and there appeared many symptoms of inflation.

§ 2. SCIENTIFIC APPROACH TO THE PROBLEM OF SHORT-TERM CREDIT

In capitalist States short-term credit consists of the temporary lending of purchasing power. In practice the banks employ the purchasing power entrusted to them by their depositors for making temporary loans to borrowers. It is, of course, an elementary attribute of short-term credit that the transfer of purchasing power to the borrower gives him a claim over any goods or services he may require. An over-expansion or inflation of credit means an excess of claims or demands for goods and services at current prices and therefore leads to a rise in prices. It is one of the chief functions of a capitalist central bank to prevent an over-expansion in the volume of credit. On the other hand, central banks in certain economic conditions may find it expedient or even essential to contract credit and thereby bring about deflation and a general fall of prices. Such considerations play practically no part in the activities of the Gosbank, because the internal price level has no connection whatever with world prices and has not the slightest influence on the foreign trade of the Soviet Government.

A good idea of the short-term credit mechanism in the Soviet system can be obtained by tracing the passage of raw material through manufacturing processes to the ultimate consumer. Cotton is a good example, for it is one of the staple commodities of production and consumption. The raw cotton is produced by collective and individual peasants, and when harvested is handed

over to the state cotton-collecting organisations, corresponding to the dealers and shippers in other parts of the world. The peasants own so little turnover capital that they not only require to be paid for their crop at the time it is sold, but in many if not most cases require loans of seed and fertilisers at the beginning of their agricultural year, advances in money or kind being made by the collecting organisations, to be repaid when the crop is sold. Since the purchase and handling of agricultural produce is a seasonal business, the collecting organisations themselves do not possess a great deal of turnover capital, their normative being the amount required to finance the period of minimum activity. Anything more than this would be lying idle for several months in the year. Therefore, when loans are made to the peasants and when the crop is bought the collecting organisations obtain an advance from the bank.

The cotton crop is gathered and delivered during a few weeks in autumn, but the spinning mills are working the whole twelve months and want comparatively small and regular deliveries of raw material. It is also impossible to transport the Central Asian and Caucasian cotton crop to the industrial centres in the north all at once. Therefore the collecting organisations have to hold gradually dwindling stocks until the next harvest, and as their stocks decline so they will repay the advance from the bank. As in all agricultural countries, harvest-time in Russia is marked by an expansion of bank credit and an increase in the monetary circulation.

Payments from the spinning mills to the collecting organisations are effected by transfers through the clearing system of the Gosbank and are financed by

bank credit to only a small degree, since the manufacturing enterprise having no marked seasonal fluctuations should have sufficient turnover capital of its own to hold normal stocks of raw material. In the same way the delivery of yarn to the weaving mills and of grey cloth from the weaving mills to the printing and finishing works are normally settled without drawing on bank credit. Finally the finished goods pass to the wholesale trading organisations who supply the retail shops. Now the sale of cotton textiles to the public is influenced by seasonal demands, and stocks in the warehouses of the wholesale organisations will fluctuate to a fairly considerable extent. Therefore credit will be required at those periods in the year when stocks are at their highest. Finally the retail shop sells to the consumer for cash. Any credit granted by the Gosbank to the spinning and weaving mills, etc., is not an advance of money or purchasing power in the widest sense. The amount of every separate advance is the exact sum required to pay for a prescribed quantity of raw or other material at the fixed price and cannot be used for any other purpose. It is only the advances to the collecting organisations which directly increase the general purchasing power in circulation, for money paid to the peasants is used by them to buy whatever consumption goods they require.

The function of short-term credit in Soviet economy is, broadly speaking, to level out fluctuations in the flow of material and goods. If there were no seasonal variations, and if all economic enterprises showed a regular state of activity, there would be no need for short-term credit, except possibly to finance the transport of goods, because every enterprise would be able to carry on with its own normative of turnover capital.

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But since seasonal fluctuations are unavoidable in the majority of enterprises, these must either possess a margin of turnover capital which would only be brought into activity at certain times, or they must be able to obtain the temporary use of additional turnover capital when necessary. One of the main reasons for planning the national economy is to prevent loss due to idle capital. This, it was thought, would be realised by vesting all surplus liquid capital, or rather the disposal of it, in the Gosbank. The bank in effect controls a reserve fund of turnover capital which it can distribute as temporary loans when and where necessary.

In capitalist countries a borrower is always able to obtain a short-term advance at a price if he can produce adequate security. The lender, whether bank or private moneylender, is not very much concerned with the use to which his money is to be put. A reputable bank may hesitate to give a loan which it has reason to think may be used for an improper purpose, but no bank would think it necessary to enquire whether a business client intends using his advance to increase his stocks, extend credit to his own customers, pay rates and taxes, or for any other legitimate commercial purpose. The Soviet financial experts, however, attempted to make a far more scientific analysis of credit than is done by capitalist banks, and to adjust bank advances not only to the general legitimate needs of borrowing enterprises but to their detailed planned requirements. Every bank advance is linked up with a specified class of goods or services, and thus in theory the Gosbank can control the distribution not merely of the general reserve fund of turnover capital but of its individual components. Obviously this could only be attempted when short-term credit is concentrated in

the hands of a single institution, and equally obviously the theory can only be completely realised when the total amount of monetary advances for a specific purpose is approximately equal in value to the amount of the available liquid capital in the form of goods, material or services at the fixed or current price. In a planned economy where all available capital should be constantly fully employed to the best advantage, a scientific analysis and apportionment of credit is a necessity. But it appears that the Soviet economists gravely underestimated the difficulty of correlating monetary credit with the available fund of turnover capital. During the first years of the reformed credit system at least the shortage of many classes of goods or, alternatively, rising prices indicated that credit was expanded more rapidly than the supply of goods was increased.

§ 3. DIFFICULTIES CAUSED BY IMMOBILISING SHORT-TERM CREDIT

At the beginning of the first Five-Year Plan the enthusiastic, but generally rather ignorant, communist directors of state enterprises were too apt to think that maximum results at maximum speed were all that mattered. The facility with which credit was obtained from the Gosbank encouraged the belief that money was of secondary importance because the State could create unlimited quantities at practically no cost to itself. It was largely this conception of the place money holds in a system of planned state economy that led to the very sharp distinction that was eventually made between short-term credit and long-term investment.

All labour and the goods produced by it can be classed

under two heads, that devoted to maintaining and increasing fixed capital and that producing consumption goods, and if the output of consumption goods is less than planned owing to waste of material or labour, either the consumption of the population must be reduced or the deficit must be made good by diverting part of the material and labour originally destined for capital production. If planned short-term credit is not exceeded it should indicate that planned production is being realised without undue wastage of material or labour. But if bank credit becomes immobilised it indicates a wastage or immobilisation of material or excessive labour costs, which will tend to reduce output without any compensating contraction in the effective demand.

Although no direct information is available there seems little doubt that a considerable volume of Gosbank short-term credit has at times been immobilised. It may have been the result of absolute loss or wastage or the conversion of liquid turnover capital into fixed or more or less immobile capital. Theoretically the bank has the right of distraining on the liquid assets of a defaulting debtor, but it is difficult to see how this provides a solution because in effect it would simply mean the State repurchasing its own property, and it may be assumed that in practice no debtor enterprise has ever actually been sold up and closed down on account of insolvency. Nevertheless, if nothing were done to liquidate or repay the frozen credit or actual losses of the bank, its short-term liquid assets would gradually contract, and eventually it might not be able to meet its liabilities to its depositors. In other words, the liquid or turnover material resources of the country would be wasted or unduly converted into fixed capital,

for the liquidity of the Gosbank's monetary resources must approximately reflect the liquidity of the country's turnover capital. If through bad management and inefficiency in industrial enterprises a certain quantity of turnover capital is destroyed or improperly converted into fixed capital, the only way in which this loss can be made good is by reducing investment in other directions, that is, by decreasing the amount of long-term credit and goods devoted to capital investment. For the sake of argument we may assume that in a given year the Gosbank's losses and frozen credit amount to R.1000 million. Part of this must be written off as bad debts and part will be represented by long-term or immobilised assets, and in so far as the total cannot be covered out of profits and reserves against losses, the bank will be compelled to reduce its short-term loans unless some other institution comes forward to bear the loss.

In practice, it appears, the bank's losses are at least partly reimbursed by grants from the national budget. The budget estimates for the years 1932-35 showed payments to the Gosbank of R.80 million, R.267 million, R.1000 million and R.992 million respectively. It was not specifically stated that these payments were in fact reimbursements of the bank's losses, but obviously the Government's expenditure on national economy must have been reduced by equivalent sums, and since it is the surplus revenue which is devoted to capital investment after current expenditure has been covered, it is reasonable to assume that these sums represented a curtailment of the Government's investment programme, and therefore the release of an equivalent value of liquid capital from immobilisation in new investment. That part of the bank's assets that had

been improperly converted by borrowers into fixed assets, however, would not necessarily represent an irretrievable loss to the State, and the bank's frozen claims may to some extent have compensated the reduction in the State's investment funds.

In the Soviet system, where production of material and goods is carried on at full capacity and the programme of capital investment is only limited by the amount of material, goods and labour available, it is most important that long-term credit and short-term credit should not overlap. Any unplanned expansion of long-term credit by diverting turnover capital to the creation of unplanned fixed capital must reduce the flow of available consumption goods. As a matter of fact this actually happened during the first Five-Year Plan, with the result that the standard of living of the population deteriorated and prices rose because of an over-expansion of short-term credit to cover excessive costs of investment. Beginning at the end of 1934, a determined effort was made by the Government to stabilise and then gradually to lower the general price level. This could only be done effectively if short-term credit were kept liquid and the total volume limited to the strictly legitimate needs of the national economy. Short-term credit, therefore, can only be advanced to finance the movement of goods, the temporary holding of stocks of turnover goods and material and seasonal activities. This is only another way of saying that the Gosbank took over the task of regulating prices by means of a managed currency. It is clear that if a stable price level can be maintained by the Gosbank through its credit policy the rouble will have a stable purchasing power, and it follows that money set aside from the budget or out of the profits of enterprises

for capital investment must also have a determinate value. In such circumstances over-investment, that is, investment in excess of savings, is impossible, for any attempt to divert too large a portion of the national income to capital investment would automatically reduce the Gosbank's credit resources, which must always maintain approximately a constant relation to available turnover capital.

§ 4. THE RELATION BETWEEN CREDIT POLICY AND PRICE LEVEL

After the credit reform of 1930 there was a steady rise in the average price level. It is true that the "commercial" price level tended to fall as the volume of "commercial" trade expanded, nevertheless the average price level, taking "normal" and "commercial" trade together, continued to rise. All funds for capital investment are theoretically provided out of real savings, firstly and to the largest extent out of budgetary funds, and secondly out of the profits of enterprises. These funds for the creation of new fixed capital are administered and distributed by the long-term credit banks and have nothing to do with the Gosbank and its short-term credit. If, then, national savings are in equilibrium with the production of fixed capital, the root of the rise of commodity prices should be found in the Gosbank and its handling of short-term credit.

The Soviet short-term credit system is subject to no automatic check as in capitalist banking systems. An unwarranted creation of credit in a capitalist country eventually leads to a depreciation of its currency abroad or to an outflow of gold. This, of course, cannot happen under the Soviet system, where external trade

is a state monopoly and planned. It is the loss of gold or a depreciating exchange which warns a capitalist central bank that it is creating excessive credit, while the member banks are limited by their available resources. In some ways the Gosbank and its branches are comparable to a capitalist central bank and its member banks. The branches of the Gosbank cannot of themselves grant more credit than their total resources. In other words, they cannot overdraw their clearing account at the headquarters of the bank except under special agreement with the head office. But it can happen that for seasonal reasons the quarterly credit and cash plan of a branch may involve greater payments than receipts. This would happen, for example, in cotton- or grain-growing districts, where the state collecting organisations would make heavy demands for credit in the late summer and autumn. But at this time the lumber industry is at its slackest, the felling and rafting seasons being winter and spring, and the branch banks holding the timber trusts' accounts will have surplus funds on deposit. Since every branch has to submit in advance quarterly estimates of its cash position to the head office, the central management of the Gosbank can calculate whether it will be called upon to increase the total volume of credit in the country as a whole or not. A net increase in credit means an expansion of the currency circulation, and a decrease a contraction of the circulation. Because Russia is still predominantly an agricultural country, the maximum expansion of credit and currency circulation occurs in late summer and autumn. This expansion is met by the Gosbank by the issue of additional currency, which according to the Plan should be exactly sufficient to finance the

purchase and movement of the harvest. Immediately after the harvest the country's stocks of grain and other agricultural raw material are at their maximum. During the following twelve months these stocks will gradually be consumed and currency should flow back to the bank. That is to say, as stocks are realised credits should be repaid to the Gosbank. This is provided for in the credit plan, which fixes the term for the repayment of advances according to the planned turnover period. If the amount of additional credit created is actually limited to the seasonal increase in the requirements of the country as foreseen by the Plan, repayment should also be according to the Plan. But while the returns of the Gosbank always show a material increase in the note circulation about the period August-October in every year, a subsequent contraction is never so clearly marked. From this it appears that it is far easier to plan an expansion than a contraction of credit.

Purchasing media put into circulation through wage payments to industrial workers, and payments to the peasants, must flow back to the bank through taxation and the sale by the State of consumers' goods. If the return flow of currency is less than the outflow, purchasing media will accumulate in the pockets of the population or in savings-bank deposits. Of course, as the population increases and the volume of available goods expands, more currency will be required and circulation will expand without any rise in prices. But it is clear from the steady rise in average price levels and the continuous pressure exerted by the Government on local authorities to fulfil their finance plans in respect of taxation, loan subscriptions and so on, that the circulation has generally increased more

than was justified by the increasing volume of trade.

In capitalist systems price levels used to be kept more or less stable by the automatic operation of the gold standard. So long as all the chief industrial countries were on the gold standard there was an automatic check on any big change in the relation between price levels in the different countries. To-day gold has lost much of its former influence as a stabilising factor and in very many countries the price level is influenced to a greater or less extent by the management of the currency by the central bank. It is sufficient for our purpose to state that a currency is managed by the device of controlling and regulating the volume and direction of credit. If management goes far enough, long- and short-term credit can be so controlled not only to raise or lower the general price level, but within limits to alter the ratio between the price level of production goods and consumption goods. Since production is stimulated or depressed by price movements, a capitalist central bank's credit policy can influence industrial activity. The situation is exactly the reverse in the Soviet system, where production is planned first and credit operations conducted in accordance with the needs of the production plan. But if credit policy does not influence production it must nevertheless be a decisive factor in determining price levels. The attempt to fix prices irrespective of the volume of purchasing power has demonstrably failed: Since planning was instituted, the natural price level, that is the price level that would bring supply and demand into equilibrium, has always been much higher than the prices as fixed by the Plan. Obviously, this is intimately connected with an excessive increase in the

volume of purchasing media in relation to the flow of available goods at fixed prices. As has already been explained in section 3 of this chapter, the failure to realise planned reductions in production costs and the high proportion of current product and labour devoted to producing fixed capital were the real causes of the rise in the natural price level, because they were the causes of over-expansion of credit and consequently of the currency circulation. Nevertheless the depreciation in the purchasing power of the rouble, which in 1935 at the natural price level was certainly no more than 20 per cent of its purchasing power in 1928 before rationing was introduced, was greater than would seem accounted for by the increased circulation alone. On 1st January 1929 the total volume of currency in circulation was R.2028 million and on 1st January 1935 R.7733 million, while the total production of large-scale industry had increased from R.15.8 milliard in 1928 to about R.47.6 milliard in 1934. The circulation, therefore, only increased slightly more in proportion than total production. But currency is almost exclusively used in retail trade and in settling insignificant accounts between state enterprises, so it may be more to the purpose to take the volume of consumption goods and not of total production. Official statistics show that the value of consumption goods produced rose from R.8.8 milliard in 1928 to R.19.7 milliard in 1934, both calculations being based on the prices ruling in 1926-27. Thus while the currency circulation expanded by 280 per cent, the output of consumption goods increased by 120 per cent. At first sight this would not seem to account for a fivefold rise in prices, but allowance must be made for the increasing use of the savings bank, in which private deposits rose from

R.213 million on 1st January 1928 to R.1150 million on 1st January 1934. If deposits in the savings bank, which are really current accounts rather than true savings deposits, be added to the currency in circulation, the expansion is only raised from 280 to 296 per cent. The velocity of circulation may have had some effect on prices, for it certainly increased between 1930 and 1935, but it is impossible to make any estimate of its effect. It must also be taken into account that other ways of spending money, such as on entertainment, recreation and travelling, increased, and that the cost of these amenities also rose; railway fares, for instance, in 1935 were very considerably higher than they were in 1928. So far as available information can be analysed, the rise in prices since the first Five-Year Plan was inaugurated does not seem entirely due to mere monetary reasons.

§ 5. THE RISE IN PRICES PARTLY DUE TO CREDIT INFLATION

A plan for new capital construction is drawn up every year in advance, the estimated money cost being covered out of estimated "savings", or in fact out of surplus revenue. As we saw in Chapter XV (Savings and Investment), the State Planning Commission draws up its programme of capital investment not to correspond with resources already accumulated, but with the estimated amount of capital that will be produced and made available during the period. Thus when a particular piece of investment, say a new factory, is begun, the bricks, cement, steel, etc., which will go into its construction are not yet in being but will be supplied out of the current production of the

brick-works, cement factories and steel foundries as and when required. The money allotted to finance this piece of investment is paid over by the Prombank to the relative trust at stated intervals, say every three months, in amounts to cover the cost of the work actually performed during the preceding period, that is in arrears. The funds administered by the Prombank are fed by continual payments from the budget and the "accumulations" of industrial enterprises and are being paid out again at about the same rate to finance new investment. Therefore, broadly speaking, the total amount of new capital investment created in a given period is paid for by the money saved during the same period. The enterprises supplying the bricks, etc., and the contractor enterprise providing the constructional labour, are paid at the end of the period for their deliveries, and the work performed during the period. But their liabilities cannot be delayed; the manufacturing enterprises have had to pay for their raw material, fuel and so on at the time they received it, and their workmen have to be paid at fortnightly intervals. The production of steel girders, etc., from the raw material takes an appreciable time; even the manufacture of bricks, cement and all the other building material needed involves expenditure some time before the goods are ready for despatch and, if the distance to the new construction is fairly long, quite possibly the transport will take two or three weeks. The average time-lag between the initial expenditure of the supplying enterprises and receipt of payment from the investing enterprise must obviously be longer, and often a good deal longer, than the intervals at which they get payment. Unless they possess considerably more than their "normative" of turnover capital they must obtain

short-term credit from the Gosbank to cover their out-of-pocket period. In fact, before the actual saving which is to finance the new investment has begun, short-term credit has been made available, part of which at any rate will be drawn in the form of notes and used for wage payments. If the total amount of short-term credit issued by the Gosbank to finance the production of building material and capital goods expands without any simultaneous decrease in the wage income in any other part of the system, there will be an increase in the total spending power of labour in terms of money, and since this expenditure has not increased the output of consumption goods there must be either a rise in prices sufficient to increase the value of the flow of consumption goods until it equals the increased flow of wage expenditure; or an increased balance of the purchasing power in the hands of the consumers, taking the form of hoarded notes or savings-bank deposits. In so far as the latter occurs, savings automatically proceed at the same rate as the disbursement of wages in the construction of the capital equipment; but apart from this the effect of the new capital expenditure must be to lead directly to a rise in the prices of consumption goods. This rise need not lead to any change in the cost to the State of providing these goods. Hence the rise in prices leads to an expansion of profits in the consumption-goods industries, part of which will as a matter of course be allocated to capital investment. Briefly, then, there is on the whole a certain time-lag between investment or the creation of new fixed assets and the relative monetary savings. If the rate of investment were constant this would have no effect on prices, but if the rate of investment is continually expanding it means

that over any longish period the money cost of new investment will be greater than the planned monetary saving. The additional savings needed to cover the gap must obviously be provided by a rise in prices.

In a capitalist system an advance of short-term credit to enable manufacturers to produce capital material and sell it on credit terms would, in just the same way as the Soviet system, cause a rise in prices if the amount of fresh credit issued or created exceeded the rate of saving, but in normal circumstances capitalist bank credit does not expand at a faster rate than savings, that is, deposits representing unemployed purchasing power.

Now if the short-term credit advanced by the Gosbank were based on genuine credit resources, that is, on the deposits of its clients in the form of unconditional purchasing power, it would not cause a rise in prices. But only the budget deposits of the State, the republics and self-governing bodies fulfil this condition. The bank deposits of economic enterprises and organisations are of two kinds, the so-called "Raschotny" account and the current account. The latter alone represents a store of unconditional purchasing power which can be drawn out in the form of notes to pay wages and for general petty cash requirements. The Raschotny account¹ is a sort of clearing account through which book entries are passed in settlement of exchanges of goods and material. Such entries represent rouble units of accounts and not units of purchasing power in the full sense. As was explained in Chapters VI and XVI, every enterprise possesses a "normative" of turnover capital consisting of stocks of raw material and goods, and a bank deposit, which is of course its Raschotny

¹ See Chapter VIII.

account. This account is credited when finished goods are sold, and debited when raw material, etc., is bought, the accounting prices being of course the conventional fixed prices. Finally, an enterprise can only use its Raschotny account for purchasing its own particular class of material. For example, an iron- and steel-works can use its deposit for buying coal, ore and the things connected with its business, but it could not use it for buying cotton, leather, fishing-nets and wine. If it had a legitimate use for such commodities it might possibly be permitted to buy them with money drawn from its current account. But in calculating its credit resources the bank makes no distinction between deposits, whether they consist of accounting roubles with a restricted use or universal current account roubles. In these circumstances it would seem clear that deposits at the Gosbank do not necessarily and automatically provide a good basis for extending credit to the same nominal amount. Of course, it does not follow that the total deposits at the bank properly provide resources for less than their nominal sum; it might equally well be the other way about. But it must be true to say that all short-term credit granted by the bank, except that advanced in the form of notes to collecting organisations for purchasing the peasants' crops, must increase the total deposits with the bank, and therefore an increase in short-term credit does not restrict the bank's ability to grant further increases. In fact, credit can be expanded indefinitely without any danger to the bank and the only effective limit is the finance plan, which seems to be drawn up more with regard to the apparent needs of industry and trade than to a sound credit policy from the banking standpoint. The bank's reply to this would be on somewhat

the following lines: credit is only granted when required to finance the movement of goods and to some extent the performance of services, and even if credit is advanced to state enterprises on the basis of unit-of-account deposits, the credit itself consists equally of the same sort of unit of account. But no amount of argument can change the fact that any increase of credit, that is, of turnover capital in monetary form, increases industrial employment and increases the total monetary income of the people. According to the quantity theory of money, prices should rise or fall in exactly the same proportion as the total supply of money alters in relation to the supply of available goods. But in the Soviet system this is no more true than in any other economic system. We must first of all take into consideration that there is a very intense demand for consumers' goods which is not effectively satisfied. The general spread of education and Soviet propaganda which raised the abstract conception of the standard of living more than Soviet industrial progress improved the concrete standard; the enormous increase of the population in the cities where desires, unknown to the peasants, and the means of satisfying them at a price exist; and the propaganda of the Government to encourage the people to spend money, really nothing more nor less than advertisement as practised in capitalist countries with the difference that it is not competitive, are all factors in stimulating the desire to spend money. Such conditions, even in the absence of a rise in average money incomes, would have tended towards a rise in retail prices.

§ 6. THE UNEQUAL VALUE OF THE ROUBLE AS IT AFFECTS CREDIT

When the Soviet Government launched the Five-Year Plan it did not intend deliberately to raise the price level. It refused to admit any depreciation of the rouble until the end of the first five-year period, about the end of 1932, and it was only about the beginning of 1934 that it began openly to talk about market prices as a real economic factor. At the beginning of 1935 it surrendered to the inevitable and officially accepted market prices as the natural price level, and ration prices as unnatural and uneconomic. We have followed the course of the financial developments throughout the planning era and analysed the mistakes which were in the main responsible for the depreciation and degeneration of the currency. It may be of some interest to try to see whether the currency could have been managed in such a way that without affecting the Plan, prices could have been kept stable. It is self-evident that, if money savings set aside out of income during any period of time were equivalent to the total amount spent on capital investment, there should not have been an excessive rise in the price level of consumers' goods. A new enterprise costs a certain sum to create, so much for material and so much for labour, and we will suppose for the sake of argument that the actual cost coincides with the estimated cost, prices not having altered. All the money spent on the new enterprise is paid out eventually in wages to workers, whose labour for the time being contributes nothing to the available flow of consumption goods. As we saw in Chapter XVI, section 5, their requirements for the necessities of life are provided by

a levy on the production of the workers producing food, clothing, etc. In short, the workers producing consumption goods are taxed for the maintenance of the workers creating fixed assets. Now assuming that every worker has approximately equal privileges in buying the necessities of life, every rouble contributed by one worker is a perfectly good unit for paying the wages of another worker; but the revenue of the State is collected from all classes of the population, and as a matter of fact those individuals, such as private traders, kulaks and so on, whose roubles have less purchasing power than those of the workers, are taxed relatively higher. It is obvious that a rouble taken from a non-worker and therefore non-privileged taxpayer is not so good a medium for paying a worker as a rouble taken from someone with equal privileges. Further, since, as we have already shown, the rouble in transactions between enterprises is only a unit of account, it seems highly probable that the "profits" of a manufacturing enterprise in unit-of-account roubles are not necessarily comparable rouble for rouble with the "profits" of a trading enterprise which sells for purchasing-medium roubles. All this substantiates the argument that, given a currency with different purchasing power under different conditions, it is impossible to say with certainty that a sum collected from various sources has an exactly calculable value when applied to a definite object, such as buying cement and steel for creating a new factory. It is true that the cost of the enterprise in material and labour can theoretically be precisely estimated since the price of the material and the rate of wages are fixed. But it is quite another question whether the nominal purchasing power of the money devoted to financing the enterprise

corresponds with the real saving it is supposed to represent.¹

The Gosbank as custodian of the currency has to submit to such conditions because they are determined by another authority. No control of credit and the emission of currency could correct the deficiencies of rationing and price-fixing. The most that the bank could have done would be to keep a more rigid control of its credit, limiting it to actual requirements and insisting on repayment at maturity. Had it done this at first it is probable that the inflationary rise of prices might have been kept within much smaller limits, but the conclusion is unavoidable that some price inflation was inevitable so long as prices were arbitrarily fixed and the purchasing power of the rouble varied according to circumstances.

At the end of 1934 the Soviet Government decided that whether or not the policy of price control and rationed purchasing power of the rouble had assisted in carrying out the Plan to date, the future economic development of the country demanded a more orthodox monetary policy. The first reform to be made was the abolition of bread cards and the sale of bread and most cereal foods and fodder at a single price. The new price was certainly fixed just as under the old conditions with this difference, that instead of calculating the price according to production cost and limiting consumption to supply by rationing, the new price was fixed at a level which was calculated to equalise demand and supply. Incidentally the prices for certain individual articles as originally fixed evidently did not turn out to be the natural price, for alterations, generally in the nature of reductions, were afterwards

¹ See note to § 4, Chapter XV.

made. At the same time the Gosbank instituted a more rigid control of credit; organisations and enterprises that were behindhand in repaying credit or that could not satisfactorily account for their own turnover capital, were refused further credit. There were two results of this restriction, or attempt to enforce financial discipline: one was an increase in the amount of wages outstanding and the other the appearance all over the country of local money substitutes. Delay in wage payments was no new thing. It was always the chief recourse of enterprises who had exhausted their credit quota. But the issue of money substitutes was a new phenomenon. Its chief form was the payment of employes by an enterprise with tokens exchangeable for meals or goods at the factory restaurant or shop. Some municipal Soviets, however, issued local loans on their own initiative. The Central Government, considering that these expedients were an encroachment on its currency monopoly as well as having an inflationary reaction on prices, immediately suppressed them. The incident had apparently no intrinsic importance, but was interesting as a symptom of the deflationary policy of the Government and the Gosbank.

CHAPTER XVIII

PROFITS, COSTS AND ACCOUNTING

§ 1. INDUSTRIAL PRODUCTION, COSTS AND PROFITS

IN Soviet-planned economy the prices of industrial goods are based on the theoretical cost of production. There is little difference between the principle of calculating costs in Soviet enterprises and in capitalist enterprises. The cost of raw material and consumption goods, labour, administrative and other overhead charges form the basis of calculation, but the reasons for calculating production costs are different. In private capitalist enterprise the manufacturer knows or can make a fairly accurate estimate of the price he will realise for his finished product. If he is starting to manufacture a new line of goods, he will make as accurately as he can estimates of production costs to enable him either to work out a price at which he can sell his goods at a reasonable profit, or, if there is already a market in the goods he intends manufacturing, to show him whether the proposed business will yield him a profit. If market prices show a sufficient margin over the production costs of any commodity, enterprise will be attracted to this field, and competition will eventually reduce selling prices until the margin of profit falls to a level which neither attracts fresh enterprise and capital, nor repels that already engaged. In other words, prices move upwards and downwards until equilibrium results. Of course this is

elementary and purely theoretical, for enterprise and capital are not very mobile in a highly industrialised State, and we have seen in the past few years how enterprises such as textile works will keep on manufacturing at a loss because the losses attending complete idleness would be still greater.

In Soviet-planned economy the difference between production costs and selling price or trading profits does not influence the volume and nature of industrial production, which is fixed by the Plan. During the first and second Five-Year Plans the production of iron and steel was considered to be of greater utility to the country than the production of consumption goods for the people. Therefore, irrespective of any question of profit, investment in heavy industry was far greater than in light industry. National savings were used to finance the construction of immense metallurgical works, machine shops, power stations, etc., although it was obvious that these could not become self-supporting, let alone make profits, for years to come. The inevitable working losses were made good by annual grants from the national budget. It would be unreasonable to expect any industrial enterprise to show a profit before it has settled down to full production; however, many if not most of the biggest Soviet industrial enterprises continued working at a loss long after they had reached maturity. But when a Soviet industrial enterprise makes a loss it cannot be regarded in the same way as a capitalist enterprise which makes a loss. If the latter continues working at a loss it will eventually disappear, because in the capitalist world losses mean a dissipation of capital; instead of the factors of production producing a surplus value their efforts result in a minus value,

surplus or minus value being the difference between total costs of production and sale proceeds. In capitalist systems production costs depend on bargains made with all the factors of production, that is to say, on the cost of material, labour and capital at current prevailing or market rates. Sale proceeds depend on the price the community is prepared to pay for the commodity produced. In the Soviet-planned economy there are no free bargains nor free markets. Soviet enterprises make profits or losses when the sale proceeds of their output exceed or are less than total production costs, but whether these are true profits or losses by no means follows. Instead of supply and demand determining the cost of labour and material and the price of finished goods, these are fixed by the Government as part of the planning system. Certainly prices of material and goods are fixed more or less in relation to their production costs, but these costs must be based in the first instance on some arbitrary decision, for the price paid to the peasants for agricultural produce, the wages paid to miners, lumbermen and all others engaged in primary production, are arbitrarily fixed, there is no element of bargaining.

All Soviet enterprises have to keep accounts and produce balance-sheets. Considerable importance is attached to proper accounting and book-keeping, for in this way only can the efficiency of any enterprise be judged. Since all book-keeping is standardised, the balance-sheets of all the enterprises belonging to a particular industry will show which of them is being operated with most efficiency and, other things being equal, the enterprise which shows the greatest surplus will be that which is making the best use of its labour and raw material. But this would not necessarily be a

true criterion in the case of two enterprises engaged in the production of the same class of goods, but situated in different parts of the country. A capitalist entrepreneur when starting a new enterprise has to consider whether it will be more advantageous to place it in proximity to supplies of raw material or to his market. He must also consider the cost of power and the supply of suitable labour in different localities. Such considerations also play a part in the Soviet Government's decision on the locality for a new enterprise. But this decision is not governed by considerations merely of profit. Political aspects must be considered, while the actual cost of transport is not so important as the need of reducing the demands on the railways as much as possible. It may therefore happen that an enterprise showing a balance-sheet loss may be of equal utility to the community with another showing a profit. Since profit-making in Soviet economy is not an absolute test of the efficiency of an enterprise and its fitness to survive, cost accounting is all the more important, for this alone shows whether the enterprise in question is showing a due return in the form of finished output for the amount of labour employed and the quantity of raw material consumed.

At the beginning of the Five-Year Plan the importance of a proper accounting system was not fully understood. In the haste to create and establish a heavy industry that would make the country self-sufficient in defence against aggression, no effective check was kept on investment expenditure. It was the rule rather than the exception for the cost of new enterprises to exceed the estimates. Even in 1934 many new enterprises were constructed at a cost 50 to 100 per cent above the estimated cost. The idea,

allowed to arise more or less uncorrected in the earlier years of the Plan, that so long as construction and production plans were realised the money cost was of minor importance, was hard to overcome. In May 1935 the People's Commissar for Heavy Industry, Ordzhonikidze, addressing a meeting of the Council for Heavy Industry, said:

"The Book-keeper should be one of the most important figures in our industry. He should be the closest assistant to the factory manager, every day and every month he should inform the manager how the business is running.

A genuine and properly drawn-up balance-sheet reflects as in a mirror the position of an enterprise. Its scope should include quality, technical coefficients, spoilt output, fulfilment of the programme, profits and losses, in fact everything. . . .

One of the chief defects of our central industrial administrations is that they have no book-keepers. It is only at the end of the year that these administrations know the results of their constituent enterprises. . . . Once and for all we must make impossible a repetition of the case in which the manager of a factory kicked out his book-keeper because he conscientiously did his job."

The most outstanding differences between the capitalist and Soviet conception of profits and the function of accounting may be summed up as follows.

Capitalist profits are due to the popular estimate of the value of a commodity exceeding the cost of production. According to communist doctrine capitalist profits are due to the exploitation of the consuming masses by the capitalist entrepreneur, but this can logically only be charged against monopolies which, instead of increasing their output to meet expanding

demand, maintain the price of their output and check demand. Monopolies, therefore, are in a position to make excessive or unjustified profits. Monopoly profits are realised by charging the consumer a higher price for a commodity than is sufficient to give the normal remuneration to all the factors of production, including interest on invested capital. Such profits, therefore, have the effect of redistributing, but not of increasing, the available wealth. In the Soviet system all large-scale industry is a state monopoly and therefore the State is in a position to exploit the consuming masses, or, in other words, to make monopoly profits. When we compare the production costs of consumers' goods with their selling prices there can be no doubt that the Russian people are exploited in this way. The fact that the State's profits are largely taken in the form of a sales tax and not shown as the trading profits of industry and trade does not alter the situation. But in these circumstances it makes it impossible to say whether individual state enterprises make genuine profits or not, and equally impossible to analyse profits to determine what proportion is profit in the capitalist sense—that is, under free market conditions—and what proportion is monopoly profit.

From what has been said above it is clear that balance-sheets cannot be depended upon to show whether an enterprise is making genuine profits or not. For the products of heavy industry, such as raw and partly manufactured iron and steel, the selling price is fixed partly with regard to the theoretical cost of production and partly with regard to the price which the consuming industries, such as machine factories, tractor works, etc., can pay, having regard to the selling price fixed for their own finished goods.

For instance, the price of a certain type of tractor was in 1931 about R.4000 (it has since been considerably reduced), but apart from the fact that this did not cover production costs, the iron and steel delivered to the factory by the Soviet metallurgical works were charged at a price which did not cover the cost of production. The same thing applied more or less to all Soviet machinery output. It followed that the losses made by the industries manufacturing producers' goods had to be made up out of increased profits on the sale of consumption goods. It is clear that if the whole series of industries engaged in primary production, manufacturing producers' goods and consumption goods had been allowed to sell their products at a price which covered their production costs and returned a legitimate profit to the State on the capital invested in them, there would have been no need to raise revenue by a sales tax paid by the consumer in order to subsidise those industries which were bound to operate at a loss. At the same time the consumer should theoretically have paid no more and no less than he actually did for the necessities of life. In practice, however, such a system would no doubt have proved uneconomic because, all industry being a state monopoly, there is no element of competition to reduce costs and obtain markets by lowering prices. Instead the State was compelled to institute a standard system of accounting in order to check extravagance and waste. But it may reasonably be supposed that this system resulted only in establishing an average standard of efficiency and competency materially below the level that would be attained under the stimulus of free competition.

§ 2. COSTS AND PROFITS OF DISTRIBUTION

In a socialist economy trading is synonymous with distribution. The true Marxist looks on the merchant and middleman in the capitalist State as noxious parasites. He is more tolerant towards the industrialist, who at any rate produces something for the use of the community even if he charges a high price for his products. It is understandable, therefore, that Soviet economists regard the cost of distribution as an unavoidable evil, and this peculiar outlook has caused them to classify distribution costs under three heads, namely: (1) expenditure which in a sense is a continuation of manufacturing costs in that it in some way enhances the utility of the goods, (2) expenditure which is in any circumstances unavoidable in distributing goods, and (3) expenditure which in present circumstances cannot be avoided, but which is not absolutely essential. These three classes may be epitomised thus :

- (1) The cost of transporting goods; sorting, blending and packing; storage in certain circumstances, *e.g.* refrigerated storage of perishable goods. Clearly if the place or time of consumption is different from the place or time of production, the value of the goods to the community is increased by transporting them to the place where they are needed or by keeping them until the consumer wants them. It also increases the convenience of handling such goods as tea and sugar in retail trade if they are put up in standard packages.
- (2) Unavoidable costs are the upkeep of shop buildings, wages of salesmen, etc. Such expenditure

does not add to the value or utility of the goods but is essential to their distribution.

- (3) Conditionally avoidable expenditure is well illustrated by the cost of safeguarding, *e.g.* night watchmen, locks, safes, etc. It is conceivable that some day when a nation of true communists has arisen nobody will dream of theft or dishonesty and precautions against thieves and robbers will be unnecessary.

But into whatever category distribution costs are placed they must increase the final selling price of the goods. It is therefore expedient to keep these costs as low as possible, and to this end accounting is necessary. That is not to say that retail turnover and the expenditure incurred are not primarily planned, but the Plan itself must be drawn up in terms of money, and in the absence of accounts it would be impossible to tell whether the Plan was being carried out. The Plan lays down in principle the total value and assortment of goods that every retail establishment shall keep in stock, the average period of turnover for every class of goods and the percentage to be added to the price to cover distribution costs and trading profits. The turnover capital of every trading enterprise should in theory equal the normal stocks of goods for distribution plus normal stocks of consumption material, *e.g.* packing and cleaning material, fuel, etc. If there is undue wastage of stocks or the turnover period is exceeded, it will be shown by the enterprise applying to the bank for credit in excess of its plan or by delaying payment to the wholesale selling organisations for deliveries of goods.

In theory the difference between the wholesale and

retail prices of goods should cover the costs of the distributive organisation and yield a certain percentage of profit, which should be devoted partly to increasing the enterprise's turnover capital, improving its premises, etc., the balance going to the State as a budgetary contribution under the head of "trading profits". The budget, however, benefits to a far greater extent from taxation in the form of a turnover tax or excise duty on goods sold. This taxation is not included in distribution costs, and in this system differs from private enterprise in a capitalist economy where the merchant, in calculating his trading expenses, must take into consideration all taxes, rates, etc., which must be paid before he earns a profit. In Soviet trade the actual selling price necessarily includes taxation, but the selling enterprise only acts as an agent for collecting the tax, the amount of which is paid straight into the budget.

Superficially, distribution costs might seem of minor importance, especially when compared with production costs. The latter have a direct bearing on the amount of goods produced for the consumption and use of the country, while a rise or fall of distribution costs does not alter the absolute volume of available goods. But if distribution costs rise, the selling price of the goods distributed must be raised to cover the increased cost, and it follows that the purchasing power of money incomes or wages will be lowered. Obviously, if a rise in distribution costs is due in an appreciable degree to waste of material, perishable food going bad, excessive fuel consumption in heating shops, etc., the total amount of goods available for general consumption will be correspondingly reduced. But according to Soviet statisticians over 80 per cent of the total distribution

costs in state and co-operative trade is accounted for by labour and service or by what might be called intangibles as distinct from the consumption, including wastage, of concrete material. Nearly the whole of the expenditure on these intangibles must take the form of wages. Increased expenditure under this head must mean either that more persons are employed in the distributive processes as salesmen, book-keepers and so on, and/or that the salaries of these persons have been raised, the result being that the consumption power of non-producers is increased and the demand for goods increased without any increase in the supply. In the absence of competition between trading organisations, there is no compelling motive to reduce distribution costs to an irreducible minimum and, in the same way as in industrial production costs, accounting can only establish an average standard relation between distribution costs and turnover.¹

In the communist philosophy, profits in the capitalist sense should find no place in a communist economy. If all the means of production and distribution belong to the community as a whole, then the products of the community's labour should be completely distributed among the members of the community. The idea of profit unavoidably connotes the idea of the appropriation of surplus value by the entrepreneur. In Soviet economy the State is ultimately the sole entrepreneur,

¹ Since the rise of "commercial" state trade, which in 1934 accounted for approximately 26 per cent of total retail turnover, an element of competition has been created between the state "commercial" shops and the peasant free market in respect to the sale of foodstuffs such as fruit, vegetables, milk, eggs, meat, etc. The consumer has a free choice in buying such goods at a state shop or in the market. This caused a general lowering of prices and an improvement in sales service which all the decrees and measures formally adopted by the Government were powerless to effect.

and in so far as the State is physically personified by the members of the Government, the State and people are separate entities. As a matter of fact, of course, the Russian people have less share in their Government than the people of any democratic country. Soviet economy is therefore an almost perfect example of state capitalism. In effect, the State trades with the people from whom it buys labour in exchange for the means of subsistence. All surplus value created by the labour of the people is in fact the profit of the State, which uses its profits to further what in its own opinion are the best interests of the country; but the opinion of the State and of the people do not necessarily agree, and this illustrates the chief difference between state capitalism and complete theoretical communism where the distinction between State and people disappears.

Out of the surplus value created by the labour of the people the State has created many economic enterprises to which it stands in the position of sole shareholder. While there is no question of the State relinquishing its ownership of all the means of large-scale production and distribution (co-operative enterprises are only co-operative in name), its policy is towards decentralisation. Eventually it seems economic undertakings, now in a subordinate and eleemosynary relation to the State, will become autonomous and independent of the guidance of the State in all but matters of major policy. Under such conditions further development of the country's resources will depend more and more on the profits or surplus value accruing to autonomous economic organisations and less on state budgetary grants. Meanwhile our analysis of the existing system of planning seems to indicate that profits are only included to allow for a certain margin of

error, for it is obviously impossible absolutely accurately to plan the incomings and outgoings of a large enterprise. To be on the safe side planned income must exceed expenditure.

§ 3. INTEREST AND REMUNERATION OF CAPITAL

In capitalist States where short-term credit and investment capital are provided by the temporarily unemployed balances and savings of individuals and private corporations, interest is the price paid by the borrower for the use of other people's capital. The rate of interest depends on the supply and demand of capital, bearing in mind that the lender's decision is influenced by considerations of security as well as by the yield of his loan or investment. The ordinary private investor cares little or nothing whether his capital is being used for a worthy purpose or for one which adds nothing to the wealth or welfare of the community. This must not be taken as a reflection on the morals of the ordinary citizen; it is merely a way of saying that he regards his own interests as normally consistent with the general interests of the community which, moreover, are safeguarded by the Government and local governing bodies. Private investments, therefore, are attracted to whatever class of enterprise for the time being offers the best return coupled with reasonable security for the capital invested. Industrial profits are very much influenced by the ephemeral fashions and desires of the population. A boom in artificial silk or wireless shares attracts the capital of the private investor because the demand for these still comparatively new things is expanding so rapidly that there is at the moment, and will

probably continue for some time to be, plenty of room for increasing the capacity of the respective industries. It may be arguable whether it is intrinsically better for the community as a whole to have more and cheaper artificial silk and wireless sets than more and better roads, better houses, cheaper and better food and cheaper and better woollen clothes. But the attitude of the Governments of capitalist States, with reservations in respect to certain dictatorships, towards this question is that what the people want is, generally speaking, good for them, and if they make a mistake it is their own look-out.

The Soviet Government does not believe in public opinion, but does believe that it has an irrefutable right as well as the obligation to decide what is good for the Russian people. Being untrammelled by public opinion, the Soviet leaders are able to take a long view and plan their economic programme in accordance with what they consider the ultimate and permanent good of the people. The average individual is prepared voluntarily to make sacrifices up to a point for the benefit of posterity, but not to the extent which the Soviet Government enforces. Therefore, apart from the ethical condemnation of private enterprise, the Government must control all capital investment, because if it were left to the private investor the country's industries would develop along other lines; that is to say, public opinion would demand a more rapid increase in the production of the necessities of life at the expense of the output of capital goods.

In Chapter XV (Savings and Investment) the way in which the Soviet Government controlled and directed the Nation's savings was described. Our present enquiry is into the remuneration of the capital invested

in national enterprises. So far as concerns capital invested by the State in state enterprises the transaction is far more comparable to a permanent investment in share capital than a long-term loan. Although the State's investment funds are distributed by the Prombank, nominally in the form of loans, the advances neither bear interest nor are repayable, but the State receives the divisible profits, if any, of all state enterprises. It is impossible to make any estimate of the average yield of capital investments in state enterprises, and it is very likely that the Government itself has only a hazy idea of the proportionate relation of profits to the total capital value of all state industries. In any case, as we saw in Chapter XIV, wholesale prices are arbitrarily fixed to cover planned production costs plus profits, and even if the planned profit of any enterprise be realised it is worthless as an indication of the real earning power of the enterprise based on the popular estimation of the utility or desirability of its products. The real yield to the State from its ownership of fixed capital consists of its dividends as represented by the proportion of total profits paid into the budget, including the profits of trading as well as industrial enterprises, plus the sales tax, excise duty and other levies which are included in the selling price of all commodities and which are paid direct into the budget. It would be an impossible task to analyse the revenue obtained by the State from its industrial and trading monopolies so as to determine the most profitable class of investment.

The State invests its capital funds in state industrial enterprises according to its own opinion of the desirability of promoting or increasing the output of various commodities and without regard to the monetary

profits that their manufacture may yield. Not all long-term capital is directly controlled by the Government. Most state industrial and trading enterprises in their balance-sheets on the liability side show an item "long-term credit". This may consist of loans from the combine or trust to which the enterprise is subordinate, from the Tsekombank for the purpose of building workers' tenements, or an advance from the local republican or provincial Government; co-operative enterprises are granted loans by the All Union Co-operative Bank and collective farms obtain loans from the Agricultural Bank. But these loans, except in so far as they bear interest and are repayable, have little in common with long-term lending in capitalist financial systems. They are always granted for a specific purpose, and the decision as to this purpose as well as the amount and terms depends in the long run on the Central Planning Commission. That is to say, while the lenders may have a certain amount of discretion in making loans they must not be influenced by motives of profit, but must invest their funds where expansion is called for by the Plan. Interest rates in such circumstances cannot reflect the relations between supply and demand of credit, nor can it be regarded as a reimbursement to the lender for the use of his capital in the same way as interest on capitalist loans. While all Soviet banks charge interest on advances, or commission as the Prombank does on its non-interest bearing grants, this revenue is primarily to cover costs and working expenses and not to make profits. The Agricultural Bank alone pays interest on deposits and has therefore to cover this expenditure by revenue.

According to the pure communist doctrine, capital as a factor of production is not entitled to a share in the

profits of enterprise. What is meant, of course, is that the private ownership of capital should not ensure the private owner an income which he does not earn by personal effort. In actual fact private citizens receive interest on their state loan bonds and savings-bank deposits and there is nothing to prevent an individual accumulating sufficient savings to afford him a living income. In practice, however, a sufficient sum could hardly be saved during a single lifetime, while death duties, rising to 90 per cent, and the laws of inheritance effectively hinder the accumulation of large private fortunes by successive generations. Although the savings of the people form only a small part of the total funds at the disposal of the Government, which probably is not consciously influenced in its choice of investment by the thought that it has to pay interest on borrowed savings, the fact remains that the interest on private savings must be provided out of the surplus value created by the workers. And if the volume of private savings lent to the Government became large enough the Government would have to pay some regard to the monetary yield of its investments. Even in the existing conditions of Soviet economy it is obvious that capital does claim its share of the surplus value produced by labour. If this were not so, the Government would be without revenue, for the workers would consume all they produced. In capitalist systems the earnings of capital are determined by supply and demand. The law of supply and demand can only come into operation when one set of people possess what another set of people want. In Soviet Russia the State alone possesses capital and the State alone requires capital. So long as the control of all industrial development remains centralised in the hands of the

Government there can never be in any shape or form a money market, and so long as this state of affairs persists, interest rates will no more reflect the supply and demand for credit than fixed ration prices reflect the relations between the supply and demand for goods. Nevertheless so long as the Soviet Government cannot satisfy all its needs for capital and must apportion the available supply in some way, it must consciously or unconsciously compare the yield or the advantages to be expected in some form from different possible capital expenditures. In deciding whether to increase the supply of capital it must balance the desirability of the resulting assets against that of the consumption goods which would otherwise be produced. Even though the question of price does not enter into the calculation, the Soviet Government, like any capitalist, must weigh up the advantages and disadvantages of investing its capital in the one way or the other, and the ratio of these two is very like a rate of interest.

CHAPTER XIX

AGRICULTURAL RENT

ALL the agricultural and pastoral land in Russia is the property of the State. Farming is carried on by three different types of enterprise: (1) the state farm, (2) the collective farm and (3) the individual peasant. The state farm is a state enterprise pure and simple, organised on much the same lines as a state industrial enterprise. The land worked by a state farm is exploited for the benefit of the community at large; the administrative and technical personnel are salaried officials and the labour consists of wage-earning workers.

Both the collective and individual peasant enterprises occupy their land on sufferance. The individual peasants form only a small part of the agricultural system and are rapidly becoming merged in the collective system, which at the close of 1934 farmed about three-quarters of the total agricultural land. Theoretically the collective farms hold their land in perpetual trust and enjoy the perpetual usufruct free of rent. The individual peasant also pays no rent, but is liable to be expropriated, as hundreds of thousands have been who would not voluntarily pool their land and property in a collective farm. But both collective and individual farms have to surrender to the State a fixed quantity of their harvest per unit of land, not, be it noted, a fixed percentage of their crop. It is immaterial for our purpose what proportion the amounts taken by the State bear to the total crop, but in very

general terms the average amount of grain demanded by the State is about two quintals per hectare out of an average crop of some eight to ten quintals. Compulsory grain deliveries therefore, on the average, amount to between a quarter and a fifth of the actual yield; for individual peasants the compulsory delivery is larger. It is, however, important to remember that the amount of the compulsory delivery differs according to locality, being scaled according to the average yield in the locality. Compulsory deliveries to the State are paid for in money, but the price is extremely low and does not represent anything approaching the natural or market price. Compulsory deliveries, therefore, contain a large element of taxation or are, in a sense, rent for the land. We shall return to this question in a moment, but before doing so some description of the general organisation of a collective farm is necessary.

The labour is provided by the members and their families working more or less on a co-operative basis. The remuneration of labour is partly in money and partly in kind. All persons performing work on the farm are entitled to a share in the divisible money surplus and in the surplus produce remaining after the payment of money taxes, interest on loans, amortisation and investment in new fixed assets have been covered out of the farm's money income and after the compulsory deliveries in kind have been made to the State and to the machine tractor stations as hire for tractors and machinery, after stocks of fodder and seed have been formed and part of the remaining produce sold on the free market for the benefit of the farm as a whole. Every worker's share is in proportion to the amount of labour he has performed during the

year. Personal incomes, therefore, depend partly on the proportion of total work each individual has performed and partly on the total surplus earned by the farm as a whole. To this extent the members of a collective farm are shareholders in a co-operative undertaking and not hired employés. We can now enquire whether the compulsory deliveries to the State are more in the nature of taxation or of rent.

In capitalist theory labour and capital are applied in agriculture up to the point at which the application of an additional unit of resources, properly combined, i.e. capital and labour of various kinds used in the most economical proportions having regard to their current prices and to the existing state of agricultural technique, will give a return in additional produce only just sufficient to recompense the farmer for his extra outlay. Since on a free market any one unit of produce fetches the same price as any other, it follows that all units must fetch a price sufficient just to cover the cost of the last, most expensive, unit that is in fact produced, and the extent to which production is carried on is determined on the one hand by the increase in cost as output increases and, on the other hand, by what the consumer will pay. Rent emerges because the total cost of producing, say, 100 units of product is less than 100 times the cost of increasing the output from 99 units to 100 units and is therefore less than the total receipts of the farmer, which will be the price as determined above multiplied by 100. This theory is independent of the system of land tenure, even if the farmer owns the land which he is farming.

In a capitalist system of landlord and tenant, rent is, in fact, a contractual payment fixed frequently for some time in advance. It cannot ever be greater over

a series of years than the normal theoretical rent accruing on the piece of land, ignoring that part of it which represents a return on the landlord's capital leased to the farmer. Otherwise the farmer will go elsewhere; or at any rate fail to pay his rent because his rent plus his costs will be greater than his total receipts. It may, of course, be less than the theoretical rent, but this only amounts to leaving to the tenant part of the advantages of using the land which in economic theory belong to its owner.

This argument presupposes a system of determining the prices of the various agents of production that are used in conjunction with land, similar to the system by which the prices of commodities are determined. Labour, for example, can be employed elsewhere than in agriculture, and the cost of it in this occupation will depend both on its productivity and on the net advantages of working on a farm as compared with working anywhere else.

When we turn to consider the Soviet economy, these last considerations may be fulfilled in so far as the price at which labour is charged up to a Soviet farm may be the same as the price charged for labour of identical skill in other occupations, and similarly for capital. If the State buys the produce at a price corresponding to the average cost of production, the farm just covers its expenses, and the profit that the State makes on the re-sale of the produce may be regarded, subject to any deduction for expenses, as the "rent" which accrued from the utilisation of the piece of land in question.

In practice it seems certain that agricultural labour is "exploited", in the sense that it is paid less per unit of effort than corresponding qualities of labour in

other occupations. This tends to depress the total cost of agricultural production measured in roubles, but it would be misleading to say that the "rent" had thereby been increased. The State really gets in addition to economic rent a monopoly profit from its power to exploit the peasant. Even so, the similarity to capitalist rent is somewhat artificial because there is no standard of remuneration in other industries worked out under comparatively free conditions with which the remuneration of agricultural labour can be compared. The matter is further complicated by limitations on the freedom of choice of individuals in expending their income. Exploitation must therefore be measured, not in terms of rouble receipts, but in terms of the real income of goods and services that the peasant in fact receives as compared with his industrial colleague of similar capacity.

But not only is the notion of capitalist cost scarcely applicable: economic rent is the difference between total receipts and total costs, and total receipts in a communist society are not quite the same thing as they are under capitalism. The price at which the bulk of farm produce is sold is determined, not by free competition, but by the arbitrary judgment of the State. In practice, the State is likely to make a decision as to the return which it desires to obtain from the use of land, to add this return to the price which it pays to the peasant and so to calculate the price at which the produce is sold. Instead of rent being the difference between returns and expenses, returns are the sum of expenses and arbitrarily determined "rent". Nor is any close limit set to the freedom and judgment of the authorities. They must not fix the price so high that agricultural produce is left on their hands. They must

not fix the price which they pay to the peasant so low that he dies of starvation. These limits are, however, very wide, particularly in a time of general shortage. Thus there appears to be little resemblance even between rent in a Soviet economy and rent as determined in practice in a capitalist economy.

One important aspect of capitalist rent is that its existence tends to promote the employment of any unit of land for that use for which, at prevailing costs and prices, it is most suitable. If an acre yields a larger rent under strawberries than under potatoes, it will be used for strawberries, and potatoes will be pushed out on to inferior land which may be worse potato land than the first, but relatively better for potatoes than it is for strawberries. In the Soviet system, however, it appears that payment received by the State for the use of the land is arbitrary and gives no indication of the use to which the land can most economically be put. The allocation of land to different agricultural uses is determined by a plan; for example, large areas formerly producing food in Central Asia, the Caucasus and South Russia have been dedicated to cotton; and this allocation may be far from the ideal which would secure the largest value of produce with prevailing systems of cultivation, bearing in mind that the consumer's preference as between, say, sugar and turnips has a bearing on the case. At present the division between crops is based partly on tradition which, on the whole, probably resulted in the land being put to its best or most economic use, all things considered, and where the traditional crops have been replaced by others it is due to the arbitrary decision of the Soviet Government based on its views regarding the best way of satisfying new or changed needs. This, however, by

no means necessarily reflects the ideal allocation of land according to the theory of rent. It is very probable that the substitution of cotton for grain, in South Russia at least, was from a purely economic point of view unsound, since it may well be that, had grain been grown and exported, the proceeds would have bought more cotton grown abroad than was in fact produced at home. The same principle applies with even more force to the attempts of the Soviet Government to cultivate rubber-producing plants. But, apart from an irrational desire for self-sufficiency, the Soviet Government takes a long view and possibly foresees a distant future when world supplies of cotton and rubber will be short.

Under existing conditions the relation of the Government to the collective farms, and to the remnant of individual peasants for that matter, is that of an exploiter or employer rather than that of a landlord receiving rent. But if and when price fixing and rationing are abandoned in favour of an open-market economy, what changes are likely to result? The Government will not be able to forgo the profits or revenue it now receives directly or indirectly from the use of the land. According to the budget estimates for 1936 the turnover tax on the sale of agricultural food-stuffs by the State will amount to R.32,000 million out of a total budgetary revenue of about R.71,000 million. This in effect means that the State makes a profit of R.32,000 million on the sale of produce bought at artificially low prices from the peasants. In a free-price economy the peasants will receive the natural price for their produce and production costs will be determined by the natural price of the material factors of production and the remuneration of the

labour of the members, which, however, will not be a fixed sum, but must at least afford them a fair standard of living not so disproportionately inferior to that of the industrial proletariat as it is to-day. The amount of the rent which should, in theory, accrue to the State as owner of the land, is the amount by which the money income of the farm, derived from the sale of all produce not required for internal consumption, exceeds costs of production and upkeep of investment. It is immaterial how the State collects its rent, but if this rent does not return the same revenue to the State as is at present afforded by the difference between its buying price and the price at which it sells foodstuffs to the consuming public, the natural selling price must be increased by some form of taxation which will fall mainly, if not entirely, on the consumer and not on the peasant producer. It seems that the introduction of a free-price system must very considerably lessen, if not entirely end, the exploitation of the peasant in favour of the industrial proletariat.

CHAPTER XX

CAN PLANNING AVOID ECONOMIC CRISES AND UNEMPLOYMENT?

§ 1. INTERNAL FLUCTUATIONS

AGRICULTURAL European Russia has been over-populated for centuries. That is to say, the amount of available labour has from quite early times been more than sufficient to cultivate the arable land. The introduction of serfdom was not due to a deficiency of labour but to other reasons, among which was the ineradicable nomad complex of the Russian people, due partly to environment and partly to the admixture of Tartar blood. For reasons of political stability and national defence, as well as in the interests of the petty princes and nobles, it was considered advisable to bind the peasantry to the land. As serfs the peasants had to cultivate the land of their owners, but the landlords did not increase the area of cultivated land in proportion as the population of the villages increased. When the serfs were emancipated in 1861 every village was allotted part of the land formerly belonging to the landlord, but, as the population of the village increased, no additional land was handed over. If a village commune or an individual peasant wanted to increase their holding, the only way was by buying land from the local landlord. Even before 1861 there was a certain growing demand for industrial labour in the big cities and most of this labour was provided by the surplus

peasant population. Those who were serfs, and that was the majority, had to get the permission of their owners to leave their villages, and for this they had to pay an annual fee. As a matter of fact, during the latter days of serfdom many of the big landlords received a greater income from this source than from the land itself. After the emancipation the peasants were still not free to leave their villages at will. They had to get permission from the Commune, and as a rule such permits, which had to be renewed every year, were only granted on condition that the absentee remitted a certain sum home for the support of the stay-at-home members of his family.

Under the conditions described, it is plain that there could not have been any large amount of industrial unemployment, for the unemployed were practically compelled to return to their villages. But in the country as a whole there must have been a great deal of under-employment. Except at sowing-time and harvest the peasants as a whole were seldom fully employed, and in winter they were completely idle unless they worked indoors at cottage industries. One of the results, or gains, of the abortive revolution of 1905-6 was a great deal more freedom of movement for the peasants, and the 1917 Revolution of course abolished every remaining vestige of restriction. As soon as industry under the Soviet began to revive, a renewed migration from the land to the towns started and industrial unemployment appeared. In 1924-25 the number of unemployed was officially given as 848,000 and the number steadily grew until 1929, when it exceeded 1.5 million. During 1929 and 1930 the demand for labour on the new enterprises, started under the first Five-Year Plan, expanded so rapidly that by the end of 1930 there were

officially no unemployed, and, officially, there has been none since and never will be. While it is true that there is no visible unemployment in the industrial centres, it should be recalled that in 1933 a large number of persons "not performing work of national importance" were expelled from the towns and left to find a living as best they could. The Soviet statistical year-book gives the average number of workers and employees in 1932 as 22.9 million and in 1933 as 22.3 million. In large-scale industry and construction the decline was over one million, against which there was a rise of 200,000 in the number of employed wage-earners on the land. It may be assumed that in actual fact there was an appreciable number of unemployed in 1933. This was due to a reduction of redundant staffs and redistribution, not to a real slackening-off in the demand for industrial labour, which in 1934 rose again and exceeded the 1932 figures.

The Soviet leaders' boast that under their system of economic planning unemployment has been abolished may be substantially true for the period of intensive industrial development, but it does not prove that planning can permanently cure unemployment. The test will come after the constructional period, when the country settles down to the normal exploitation of its resources. It remains to be seen whether markets can be found for the eventual output of all the industrial enterprises created, the potential capacity of which will be enormous by the end of the second Five-Year Plan in 1937. One of the causes of the unemployment crisis in the capitalist world was the sudden cessation of capital investment. This caused a rapid fall in the amount of labour employed in creating capital goods, with a consequent reduction in the demand for

consumption goods. So long as all the factors of production are only partially employed, as is usual in industrial capitalist countries, a rapid increase in capital investment without a corresponding increase in the rate of saving causes a rise in prices of consumers' goods, an increase in their production and consequently increased employment, while a decline in capital investment has the opposite effect. The Soviet Government is in the position of being able to co-ordinate the rate of capital investment with the rate of saving because the decision to save and the decision to invest rest with one set of people and not with two classes with different and often conflicting interests. There should therefore be no danger of a rapid decline in capital investment throwing large numbers of workers out of employment, thus leading to a reduction in the demand and a fall in the price of consumers' goods.

The intensive industrial development of the country under the Five-Year Plan was accomplished by a drastic curtailment of current consumption. The wealth of the country and the national income were enormously increased and this was reflected in a great expansion of the money income of the population, but, owing to the very modest increase in the output of available consumption goods and insufficient voluntary monetary saving, the effective demand was not satisfied. In due course the investment of capital in creating the means of production will result in a big increase in the output of available goods for which there would seem to be almost an illimitable market. But if the Soviet economy eventually goes over to open-market conditions and the law of supply and demand,¹ it follows

¹ The complete abolition of rationing which became effective on 1st January 1936 was necessarily accompanied by something approaching

that the people's demand for consumption goods must be backed by real purchasing power. Under the planning system prevailing during the first and early part of the second Five-Year Plan high production costs in industry scarcely, if at all, restricted demand. The Plan provided for the output of a certain quantity of consumers' and capital goods and for their distribution irrespective of the intensity of demand. There was no question of seeking markets; the only problem was to distribute the current output where it would be of the greatest utility in the view of the Government. If production costs rose or failed to fall as much as was planned, it meant either that material was wasted or that there was inefficiency in manufacturing processes or more usually both. Higher production costs were reflected in higher selling prices, but also meant in some way or other a greater issue of purchasing media and therefore an increase in the nominal purchasing power of the people. All material is the result of successive applications of labour, and therefore the final cost of any manufactured article is the sum of all the labour that has gone into producing and transporting the raw material, into the successive stages of working up, plus the cost of the labour employed to produce power, light and so on. It is clear that, whatever be the final money cost of any article, the same amount must have been distributed somewhere and some time in the form of wages. It would seem, therefore, that production must always create a corresponding income and hence a corresponding demand, and this in fact is roughly the

open-market conditions in retail trade, and while wholesale prices were still mainly based on production costs, indications pointed to the gradual if only partial formation of a wholesale market with some freedom of bargaining.

idea behind the Soviet Government's belief that it has cured unemployment for all time.

Theoretically the argument holds good. So long as supply falls below demand for all or most of what is produced, there can obviously be no question of inability to dispose of the product. But once the same sort of balance between supplies and effective demand as exists in richer communities has been established, it will be possible for mistakes to be made in the direction of production to different demands, more being made of some things than consumers are willing to take at a price sufficient to cover the costs, and less of other things than consumers would absorb at a price sufficient to cover costs. Unemployment is not a condition likely to occur in a community in which there is a universal shortage of commodities. But even if the Soviet Government succeeds in maintaining equilibrium between demand and production, when the scarcity of consumption goods has been overcome internal and external issues are bound to arise which will tend to upset this equilibrium unless appropriate and effective measures are taken to counteract them. Among internal eventualities there may be changes in demand arising from altered tastes and modes of living and harvest fluctuations. In the capitalist world changes in fashion and habits and mode of living have occasionally been so rapid and so material that certain industries have been almost if not quite ruined and serious unemployment created in certain districts. This should not occur in Soviet Russia so long as the State has the power of controlling all industrial output. A capricious change in demand would not be pandered to, while changes due to changes in the social structure and conditions of life come about gradually and

should usually be anticipated without difficulty by the State.

Planning, however, if it is effectively to anticipate changes in demand, must, one would think, be highly centralised; but centralisation has proved to have certain faults, and the tendency is to grant a considerable measure of individual discretion to economic enterprises. In such circumstances it is quite conceivable that planning might not be able to exercise such an immediate control of production as to effect the necessary adjustments in time to avoid the results of changing demands.

Russia is notoriously a country in which big harvest fluctuations occur as the result of climatic conditions, and though improved farming methods will go some way towards counteracting the effects of drought and excessive rainfall, there will always be a big spread between the best and worst harvests. An exceptionally bad harvest would reduce the purchasing power of the agricultural population for manufactured goods and, by causing food prices to rise, would compel the industrial population to spend a greater proportion of its income on food and less on industrial goods. In pre-War Russia the harvest had a very great effect on the turnover of the cotton textile industry, which was by far the most important industry supplying goods for internal consumption. It would seem that in Soviet Russia when the output of consumers' goods exactly corresponds to demand, the same causes would have much the same effects. As a matter of fact the reaction of the harvest on industry should be even greater than before the War, because a much larger proportion of the raw material for industry is now produced internally instead of being imported. The more self-sufficient

a country the more national consumption depends on national production, and if for any reason production permanently or temporarily declines, consumption must be reduced. If the labour of the agricultural population in any year results in markedly smaller production than the normal, this section of the population must restrict its consumption of manufactured goods or must be supplied with its requirements at a cheaper price; that is, in terms of material it must be given industrial goods in exchange for a smaller quantity of agricultural produce. In one case the amount of labour producing industrial goods must be reduced, in the other case the same amount of labour can be employed if real wages are lowered in agreement with the reduced purchasing power of the agricultural population. The obvious remedy is for the State to build up a sufficient carry-over reserve of grain, raw cotton, etc., to cover deficits in bad years. This would be an insurance against fluctuations in the supply of food and raw material as the result of climatic conditions, but it would by itself not prevent fluctuations in the purchasing power of the agricultural producers, especially as it may be assumed that action will be taken to prevent large haphazard fluctuations in the price of agricultural produce. The counterpart to a reserve fund of material would be a monetary reserve. That is to say, if the State holds a reserve of food and material for which it has paid out money, the producers should similarly hold a monetary reserve to cover their requirements in years when their earnings are below the average. During the first half of the second Five-Year Plan compulsory agricultural insurance against local crop failures from hail, pests and other eventualities was extensively developed, and it would only be a

step further to insist on the collective farms building up an insurance or reserve fund in good years to supplement their purchasing power in bad years.

Theoretically, perhaps, successful planning may eliminate unemployment, but it has not yet been proved. The absence of unemployment since 1930 is clearly not attributable so much to planning as to the Government's investment programme, which resulted in a general shortage of consumption commodities. Some day the ratio of investment to national income will fall to more reasonable proportions and then the supply of consumption goods will satisfy demand at prices yielding no extravagant margin over production costs. In such circumstances if planning is to prevent unemployment, or more accurately prevent conditions arising which in a capitalist system would result in unemployment, it will need to be carried out with almost superhuman prescience; in fact, with a perfection that human organisation can scarcely attain. Of course, absolute unemployment can always be avoided by employing surplus labour at a loss on the principle of relief works in capitalist countries. But to substantiate the claim that planning can overcome unemployment it must be shown that it is capable permanently of finding remunerative employment for the whole body of workers.

§ 2. EXTERNAL DISTURBANCES

Although Soviet Russia is highly self-sufficient, world economic conditions must have some repercussions on the internal situation. During the period of intensive industrial development, between 1929 and 1933, the effects of the world economic crisis were

felt in Russia, though contrary to the experience of capitalist countries it did not cause unemployment. The first Five-Year Plan came into operation towards the end of 1928; the date on which it officially began was 1st October. The industrial part of the Plan provided for the extension and reorganisation of existing enterprises and the creation of new enterprises and even new industries. A large amount of foreign material and manufactures was necessary to carry out the planned developments and the Five-Year Plan contained estimates of the amount of Soviet products, chiefly grain, timber and oil, that would have to be exported to pay for the imports. These estimates were based on world market prices ruling in pre-crisis times, but when the Soviet industrial development programme called for the largest volume of imports in the years 1930 and 1931, the world market prices for those commodities which Russia could export had fallen very much more than the prices of the goods Russia needed to import. Rather than curtail imports and slow down the Five-Year Plan, the Soviet leaders decided to force exports at the cost of current consumption, which meant of course a lowering of the standard of living. The Soviet Government was able to do this because it did not have to consider the internal price of the goods it exported, but it is obvious that if the Government got a smaller return for its exports it could not afford to give the same return in the form of real wages to the labour which produced the goods.

In industrial capitalist States, particularly those manufacturing extensively for export, a fall in the price of industrial goods sooner or later means unemployment. The entrepreneur ceases to manufacture when the loss incurred in producing and selling goods

is greater than the loss involved in keeping plant idle. Although a fall in the price of raw and auxiliary material may accompany the fall in the price of the finished article, other production costs, mainly wages, and permanent charges such as rates and certain taxes, pensions, etc., are relatively fixed and inelastic. In agricultural countries such as Canada and Australia, where the farmers or many of them are entrepreneurs in the sense that they employ labour, a fall in the price of agricultural produce tends at first to reduce employment on the land and afterwards, if the crisis continues, to put land out of cultivation. In countries of peasant holders—that is, most European States—there will not be much agricultural unemployment, but the peasant farmers must reduce their standard of living because their purchasing power falls.

So long as Soviet Russia has an appreciable external trade, changes in the relative world market prices of raw material and manufactured goods must have some reaction on real internal prices. Changes in the purchasing power of gold would only affect Russia in so far as she is a large producer of gold. From what was said in the previous paragraph it may be accepted as axiomatic that when there occurs a fall in the price of a particular class of commodity in relation to the general price level, the entrepreneur employing capital and labour in producing that class of commodity will reduce output and dispense with labour; while the craftsman and peasant who has no capital to speak of and depends entirely on his own labour and that of his family continues to produce, unless there is a total absence of demand for his output, but will reduce his consumption in accordance with his reduced purchasing power. At first sight, Russia is a land of large

capitalist enterprises; all state enterprises are capitalist in all essentials, the only difference between them and capitalist enterprises elsewhere is that the sole shareholder and entrepreneur is the State, or in theory the whole population. In capitalist countries every individual's interests are bound up with some particular enterprise or industry, therefore what is good for one part of the population may be neutral or even detrimental in its immediate effects on another part. In Russia, since every citizen theoretically has an equal share in all state enterprises, there should be no conflict of interest between one set of people and another. In the capitalist system unemployment is ultimately connected with conflicts of interest between one set of people and another; if everybody, producers, consumers, entrepreneurs, wage-earners and the owners of capital were prepared to make sufficient sacrifices, consumers could be found for all the products of labour. Under the Soviet system, as has been pointed out already, everybody theoretically combines all these qualities in the same degree. Therefore, also theoretically, any reaction from world economic depressions could never cause unemployment, but in so far as it caused a reduction in the flow of available goods it would mean a general and equal lowering of everybody's consumption of current goods.

But under the Soviet system there has always been a sharp conflict of interests between the industrial proletariat and the agricultural peasants. So long as the peasant wants to exchange his surplus for as much industrial goods as possible and the industrial worker wants his food to be as cheap as possible, this conflict must continue. The Soviet Government hopes in time to teach both that, in the long run, their interests are

identical and not contradictory, but it seems more likely that the greatest satisfaction of the greatest number will be attained when the exchange of agricultural produce for industrial goods is based on the law of supply and demand. To allow world market prices as well as internal conditions to exercise their full effect on the relative purchasing power of each class for the other's products would be incompatible with economic planning, which aims at obliterating irregularities in supply and demand. Planning does not, however, entirely exclude open-market conditions for the exchange of goods, but Government intervention will be necessary to counteract any causes which would otherwise produce irregularities. That is to say, any increased prosperity caused by a rise in world market prices of raw material, which under capitalist conditions would principally benefit the primary producers, would be directed by the Soviet Government to benefit the whole community equally. Conversely the adverse effects of a fall in raw material prices could be spread over the whole community instead of being borne mainly by the primary producers. The desired result might be achieved by a crude redistribution of income, or thinly disguised price control; more scientifically, perhaps, by appropriate monetary and credit management, but in any case by direct interference with the natural course of events.

If we are to credit the Government with the wisdom and impartiality to carry out an equitable and scientific redistribution of the national income, we must assume that the various Government departments invariably co-operate in perfect harmony. But it would be just as absurd to imagine that there is no jealousy nor friction between the various Soviet People's Commissars

and Commissariats as it would be to believe that the different ministers and ministries in any capitalist Government always see eye to eye.

If we bear this in mind it seems that the claims of the Soviet leaders and their foreign supporters, that the Soviet system of a planned economy is superior to the capitalist system, are largely based on the assumption that the directors of the Soviet economy possess a degree of wisdom, altruism and capacity for harmonious co-operation denied to capitalist leaders. Is there in actual fact any reason to believe that the Soviet leaders as men are less tainted with human faults and imperfections, such as jealousy, avarice, intolerance and lust for power, than the political and industrial leaders of capitalism? If in reality they possess the ordinary human frailties in much the same kind and degree as capitalist mankind, is it not possible that the Soviet system will fall just as short of perfection as capitalism?

CHAPTER XXI

FOREIGN TRADE

IN Chapter XIV, section 10, it was shown that the decision of the Soviet foreign trade monopoly what sort and amount of commodities to export and what goods to import was determined by an arbitrary estimate of what could be spared from internal consumption and what was most necessary at the moment to further the Five-Year Plan of industrialisation. So long as rouble prices were fixed without regard to supply and demand and the distribution of consumption goods determined by rationing, the Government was unable to tell with scientific exactness whether a ton of wheat or a ton of petroleum was more advantageously consumed internally or sold abroad to buy foreign goods. Because of the unforeseen fall in the world market prices of agricultural produce and raw material after 1929, the Soviet Government had to export a greater volume of grain, timber, oil, etc., than they had allowed for in order to import the quantity of machinery, etc., which they needed for their industrialisation programme. It is beyond question that during the years 1931 to 1933 large sections of the population were under-nourished partly because too much foodstuffs were exported. This under-nourishment caused a decline in labour efficiency, and it is questionable whether this did not do more to slow up the progress of the Five-Year Plan than a reduction of imports would have caused. In any case, the rouble

was useless as a measure of value to determine whether the real loss to the country of the goods exported was made up by the intrinsic value of the resulting imports.

In 1933 the Government began to realise that it would be better to limit imports to the value of the exportable surplus that could be spared without harmful reactions on the efficiency of labour, and since the most intensive stage of the industrialisation programme had come to an end with the first Five-Year Plan on 31st December 1932, it was possible to take a calmer and more objective view of the situation. In 1930 exports were valued at 1036 million gold roubles; in 1931, owing to falling world market prices, the value fell to 811 million while the volume rose from 21.5 million tons to 21.8 million. In 1932 the volume fell to 18 million tons, entirely owing to the comparatively poor harvest in 1931 which reduced grain exports from 5 million tons in 1931 to less than 2 millions. In 1933 the volume of exports was approximately the same as in 1932 while the value fell from 575 million gold roubles to 495 millions. In 1934 the volume fell further to 17.3 million tons and value to 418 million gold roubles. The figures for the years 1930 to 1935 in tabulated form are:

	Volume of Exports in Millions of Tons			Value in Millions of Gold Roubles
	Total	Grain only	Other	
1930	21.5	4.8	16.7	1036
1931	21.8	5.2	16.6	811
1932	18.0	1.8	16.2	575
1933	17.9	1.8	16.1	495
1934	17.3	0.8	16.5	418
1935	17.2	1.5	15.7	367

Probably a more rapid decline in the volume of

exports would have occurred but for the fact that the Soviet Government had to find foreign exchange to meet maturing liabilities due to previous imports.

The Soviet Government includes in its exports such things as butter, sugar and cotton textiles, all of which are very scarce in the country. So long as these things were sold at ration prices there was no way of telling whether the export of, say, £100 worth of butter caused a greater deprivation to the Russian consuming public than £100 worth of sugar or cotton. When an appreciable quantity of these things were made available in the commercial shops it became possible to compare the intensities of the demand for different goods. If, for example, the free retail price of butter is obviously higher in relation to wholesale or export prices than that of sugar, it shows that if the choice lies between exporting butter and sugar it would be in the better interests of the population to export sugar until its internal price is more nearly in the same ratio to the export price as the price of butter. Given the necessity to obtain a certain sum of foreign exchange by the export of goods, internal prices formed by the operation of a free market indicate which commodities from the point of view of the people can best be spared. But this is only half the problem.

Russia produces certain commodities in amounts exceeding the absolute minimum internal requirements, otherwise of course there could be no export. If the Government is sincerely trying to create the best possible living conditions for the people, the time will come when the choice of exports will be decided by whether the resulting imports give greater satisfaction to the people than they would enjoy by consuming their goods at home. In Chapter XIV, section 10, it was shown

that a kilo of butter bought from the peasants for R.2.50 when exported realised 25.6 kopeks, nominally, about one-tenth of the purchase price. At these prices the Soviet exporting organisation makes a paper loss of approximately R.225 on every Kg.100 exported, because it must sell the foreign exchange obtained on the foreign market to the Gosbank at a rate based on the nominal gold content of the rouble. On the other hand, an importing organisation buys foreign exchange from the bank at the same rate. Reverse the transaction in butter and it appears that a kilo bought abroad with foreign exchange costing 25.6 kopeks could be sold in Russia for R.26, or 100 times what it cost¹. The paper profits on the sale of imported consumption goods such as tea are enormous, and in practice the profits on imports are in some way set off against the losses on exports. But in these conditions it is quite impossible to tell whether the consuming public is willing to exchange part of the available butter for imported tea. If, however, the organisations engaged in exporting and importing consumption goods were linked together so that the importers had to buy their foreign exchange from the exporters at a mutually agreed rate, the real commodity value of the rouble would soon emerge. In all probability butter would not be exported at all because of its scarcity, but certainly the importers of tea and various other colonial goods, and probably of clothing, would be able to pay for foreign exchange at a rate which would enable the exporters of agricultural produce, chiefly grain, to make a reasonable

¹ On 1st April 1936 the exchange value of the rouble was fixed at 3 French francs, a fall of about 77.5 per cent on the previous rate of about 13.33 francs. The new rate was still arbitrary and, though it lessened the extreme difference between internal and external prices, left the rouble much overvalued in terms of foreign currencies.

profit. If the internal trade in production goods were conducted on open-market principles, the importers of machinery, etc., and the exporters of timber, oil, etc., would be in the same position as the organisations dealing in consumption goods. In fact open-market conditions in external trade would presumably have to be introduced simultaneously for all sections, but it would first be necessary to abolish arbitrary price-fixing and allow the internal purchasing power of the rouble to find its natural level under open-market conditions. In time these conditions may be realised, unless the Government alters its economic policy, and then the exporting organisations will only sell goods abroad when the roubles received in exchange for their foreign exchange at least cover the rouble costs and charges involved in purchasing and transporting the goods. At the same time the importing organisations will only import when they can sell their goods internally at a profit. That the Government will surrender its monopoly of foreign trade is not to be expected, for this is one of the fundamental principles of Soviet planned economy; but even if the various state trading organisations are granted greatly increased independence and initiative, the Government can still exercise effective control by means of import and export duties and bounties.

It may be of some interest to try to forecast what changes may be expected in Soviet foreign trade if and when internal open-market conditions and decentralisation allow the exporting and importing organisations to conduct their operations on more or less customary and orthodox competitive lines. There are a large number of organisations engaged in foreign trade, such as those exporting timber, grain, oil, furs,

coal, preserved foods, flax and so on, and those importing various raw material, machinery, consumption goods, etc. These are all, of course, state enterprises, except *Centrosoyus*, the central organisation of the consumers' co-operatives, which exports and imports various consumption goods for account of the co-operative system. *Centrosoyus* could, of course, use the proceeds of its exports for purchasing imports, but information is lacking whether in fact it does so or has to surrender all the proceeds of its exports to the Gosbank and purchase its foreign exchange requirements from the same institution. As we have seen, so long as the exchange value of the rouble is over-valued in relation to its internal commodity value, exporting organisations must operate at a heavy paper loss and importing organisations make big paper profits. Obviously they cannot work on commercial principles, but merely carry out the decisions of the Government. Sooner or later, it may be expected, they will become more or less autonomous and trade with a view to making profits, being responsible for their own commitments and liabilities. As a matter of fact, a decree was issued on 4th August 1935 permitting certain of the most important foreign trading organisations to negotiate directly with foreign buyers and sellers and to conclude contracts on their own responsibility, though still under the general supervision of the Commissariat for Foreign Trade. Of course, so long as these organisations have to buy and sell their foreign exchange at the Gosbank's official gold-rouble rate and buy or sell their goods internally for paper roubles, there can be no real commercial trading. They were permitted under the new order to give and accept bills in foreign exchange, but a bill given by an individual Soviet

trading organisation would obviously be a doubtful security unless endorsed by an authorised representative of the Government such as the head of a commercial mission abroad, a member of the Commissariat for Foreign Trade or by the Gosbank. Although all state enterprises are constitutionally state organs, the Government maintains the fiction that an enterprise is solely responsible for its own actions and liabilities unless these have been expressly guaranteed. Since the Gosbank is not legally bound to redeem its notes by gold or foreign exchange, an importing organisation might be refused the necessary means of paying its foreign suppliers unless its bills were guaranteed. Payment in roubles would be useless to the foreign supplier, who would be equally unable to obtain foreign exchange from the Gosbank or to use his roubles for purchasing goods for export. From the point of view of the foreign manufacturer and merchant the decree left the situation unchanged so far as payment was concerned, though in certain circumstances it should expedite and simplify negotiations, which can be carried on between principals instead of through an intermediary in the form of a Soviet commercial mission or agency. The decree was nevertheless a rather significant step in the direction of decentralising foreign trade.

If it be assumed that in course of time Soviet foreign trade will be carried on under commercial conditions by more or less autonomous state trading trusts, the "Most Favoured Nation" clause will have a real meaning in Soviet commercial treaties. It is inconceivable that the Government which itself imposes import duties could be influenced by these duties in favour of importing from one foreign country as against another; but when the country's trade is carried on by independent

trusts working on commercial lines and free from direct and arbitrary control from above, they will naturally be influenced by import duties and, other things being equal, will buy in the cheapest and sell in the dearest market. While the Commissariat for Foreign Trade has by no means disregarded questions of price, there is no doubt that the course of trade has not infrequently been influenced by political considerations to take a direction other than might have been dictated by purely economic considerations.

The decentralising and commercialising of external trade cannot take place all at once, but rather by a process of gradual evolution. The first requirement, as already pointed out, is the abolition of differential price levels and the introduction of an internal open market; the second is an exchange rate for foreign currency based on the commodity value of the rouble and not on a mythical gold content. These changes will probably come about more or less concurrently with a relaxing of the intensity of the industrialisation programme. After the close of the second Five-Year Plan at the end of 1937, the further development of the country's industrial capacity—that is, the creation of new fixed capital—will be slowed down to correspond with a far more moderate rate of saving than during the first and at least the first three years of the second Five-Year Plans. Unless the Soviet Government succeeds in obtaining a fairly large and long-term loan abroad, the importation of production and capital goods, which already in 1934 and 1935 showed a marked decline compared with 1931 and 1932, will probably continue to decline, at any rate in proportion to total imports. The value of total imports will be determined by the value of exports, and exports will depend on

there being a genuine exportable surplus and not on the irreducible consumption needs of the country. Since internal consumption is extremely low it is certain that increasing production will not produce an increasing export surplus for a considerable time. It is, in fact, the avowed intention of the Government to increase internal consumption per head in 1937 to double its volume in 1933. It is by no means certain that productive capacity will have increased sufficiently to make this possible. But it is fairly certain that the average standard of living in Russia will gradually and steadily improve, and such an improvement will assuredly be accompanied by a growing demand for more luxury or semi-luxury goods, a considerable proportion of which must be imported. This will bring about rather important changes in the nature and composition of imports if not of exports. Primarily the essential needs of industry for certain raw materials not found in Russia, and for such machinery and apparatus as cannot be produced internally, will still have to be satisfied, but a considerable part of the balance of the country's importing power will be devoted to such luxury or semi-luxury goods as, in the opinion of the public as shown by open-market prices, are worth the sacrifice entailed in exporting the necessities of life.

CHAPTER XXII

A FINAL SURVEY AND CONCLUSIONS

§ 1. FINANCIAL PLANNING LEADS TO INFLATION

IN the previous chapters of this book we have examined the Soviet monetary and financial system and theory in considerable detail, and have seen that in many instances, where the Soviet economists tried to disregard the fundamental laws of an organisation based upon capitalist production and exchange, they but tended to demonstrate that these laws apply with equal force to a socialist economy. To the student of financial theory and practice the Soviet experiment must be of deep interest. Though a final appraisal will be impossible for some considerable time, for the experiment is by no means ended, some conclusions may already be drawn. The fact that a number of the measures adopted during the earlier part of the planning period were afterwards revoked and that certain theories at one time officially endorsed were later officially stigmatised as fallacies, does not necessarily mean that all the innovations introduced into Soviet financial methods were failures in proportion as they departed from capitalist orthodoxy. Because the ration system for the distribution of consumption goods was, at the end of 1935, to all intents and purposes abandoned in favour of an open retail market, it does not follow that rationing was a failure. The truth is that the reasons which caused the adoption of rationing in

1929 were no longer operative. Rationing was, as a matter of fact, a temporary expedient adopted to meet abnormal conditions. In connection with rationing a very marked and, some might say, a cynical *volte-face* was made by the Soviet Government. During the first Five-Year Plan and up to the end of 1933 the retail price level was officially held to be that ruling for rationed commodities; the free market on which prices were many times higher was ignored, though it supplied an appreciable proportion of the goods consumed by the average worker and should properly have been taken into consideration in calculations of the cost of living. When the retreat from the ration system was officially announced the ordinary citizen suddenly learned that the proper retail price level was that ruling on the "commercial" market and that ration prices were artificially low. This was a tacit rejection of the theory that the value and the price of any article is determined by the amount of labour-time involved in its production and an acceptance of the orthodox theory that price is the result of the reaction of supply and demand. Whether this foreshadowed a definite repudiation of the Marxian theory of value was not made clear, though it seems that this theory is likely to be abandoned sooner or later as a guide to practice. But it is not a simple matter to decide how far Marxian theory on the one hand and mere expediency on the other dictated the Soviet financial policy, though there can be no doubt that doctrinaire theory has never been allowed to interfere with the economic plan when it conflicted with expediency. This was clearly shown by the wages policy in industry. While the doctrine of "levelling", that is, of equal remuneration irrespective of the skill and technical

knowledge required for the job, was never completely applied, the difference between the remuneration of the qualified engineer and the ordinary manual labourer was very small at the beginning to the first Five-Year Plan. When it became clear beyond any doubt that highly skilled engineers as a rule tried to avoid positions of responsibility because the scale of remuneration was not commensurate with the liabilities incurred, the Government took steps to improve the standard of living and environment of its more valuable employés. It was officially announced by no less an authority than Stalin that it was entirely consistent with communism that the remuneration of the worker should depend on his intrinsic value to the State.

While a number of communist principles were sacrificed when they proved incompatible with economic exigencies the fundamental principle of collective ownership of the means of production and distribution has been faithfully observed since the N.E.P. interlude. In some directions increased individual economic liberty was conceded after the close of the first Five-Year Plan. At the beginning of 1935 the amount of land and live-stock that the individual members of collective farms might possess for their own use was fixed by decree and materially increased; it is also possible for individual urban proletarians to own houses for their personal use. In these ways the idea of communal living as distinct from communal enterprise has been modified. But all such relaxations of the tenets of pure communism have not in any way modified the economic structure of the country, which can be described as state capitalism with a fringe of local co-operative enterprise. While there may and probably will be further changes or modifications in

the design of the economic pattern before a permanent form is reached, any alterations of the main structure seem unlikely.

We have seen that up to the beginning of the first Five-Year Plan no serious monetary experiments were tried, except the short-lived attempt to do without money during the period of War Communism. But the centralisation of industry and trade in the hands of government departments created a situation which called for some adjustments in the financial system. At first there may have been a certain tendency deliberately to evolve a system as different as circumstances permitted from orthodox capitalist financial systems, but even if this was the case, later adjustments were dictated solely by experience. Since socialism on such a scale as that born of the Bolshevik revolution had never before been tried in the history of the world, the new leaders of Russia were compelled to look for guidance to the theories of the nineteenth-century prophets, most of whom had specialised in metaphysical conceptions of revolution and but few, if any, in producing practical text-books for the guidance of the pioneers in socialist government. The War Communism of 1918-21 proved nothing; it failed partly because of the abnormal situation resulting from the World War and the subsequent civil war, and partly because it was introduced without any preparation. It was not until the first Five-Year Plan that a concerted attempt was made to place the national economy wholly on a planned basis and substitute the capitalist theories of money, prices and credit, which had prevailed during the N.E.P. by socialist theories. The first moves were necessarily empirical. The first important monetary problem to be solved was how to

prevent a rapid rise in the retail price level in face of an ever-increasing wages bill without a compensating increase in the available supply of consumption goods. The method adopted was rationing. But it can scarcely have escaped the notice of the Soviet economists that this expedient was bound to lead to an accumulation of unexpendable purchasing power in the pockets of the wage-earners. Theoretically the population should have saved its surplus income until the increasing flow of consumption goods resulting from investment in the means of production afforded an outlet. In practice everybody tried to convert his surplus monetary income into something tangible, hence the extravagantly high prices in the very limited free market. The inevitable result was the creation of an inflation psychosis which reacted on the whole monetary system. Many of the ills which subsequently afflicted the rouble are directly or indirectly traceable to this initial miscalculation and the adherence to the Marxian doctrine of value.

When all industrial enterprise belongs to the State as sole entrepreneur the cost of labour is not measured by money wages, but by the goods and services distributed by the State to the workers. Therefore the production cost of an article as measured by the amount of money wages paid out in the course of its production is quite a different thing from its cost as measured by the amount of goods and services distributed and consumed in its manufacture, unless money wages possess a stable purchasing power in an open market where prices are determined by supply and demand. The Soviet Government was driven to the necessity of rationing and price-fixing by its determination to develop the country's natural resources and build up

a heavy industry in the shortest possible time. This involved a drastic restriction of consumption, which, had it been enforced by raising retail prices or reducing money incomes to the requisite degree by taxation, would certainly have caused a great deal of discontent. To some extent rationing served to conceal the real measure of enforced saving and possessed the additional advantage that preference by means of differential ration categories could be given to the industrial workers, who both politically and economically were the most important section of the population.

It would serve no purpose to discuss academically possible alternatives to the rationing system, which in the circumstances was probably no worse than any other device the Soviet Government might have employed to achieve its object. But its reactions on the whole monetary and financial system should repay examination. All industrial enterprises had to sell their output at prices based on the theoretical money cost of production, which depended directly on the wages of the workers employed and indirectly on the wages of workers in other enterprises delivering raw material, electric current, etc. Since the fixed selling price in nearly all heavy industry and in a very large number, possibly a majority, of light industry enterprises did not cover real production costs, a large volume of industrial losses were incurred by the State. While some losses were "planned", the amount of unplanned losses to be covered by treasury grants every year was very considerable, especially in the early years of the first Five-Year Plan. There is no doubt that these losses were, to a considerable extent, made good by the printing press. It is only necessary to compare the increase in currency circulation between 1928 and 1933 with

the expansion laid down in the original Plan to be convinced of this. The Plan provided for a maximum circulation in 1933 of R.3200 million; the actual circulation was about R.6800 million. Costs of production exceeded estimates because the productivity of labour was less than expected. In other words, labour received a higher money wage in proportion to results than was provided for by the Plan. Had commodity prices been fixed in accordance with actual production costs as determined by proper costing there would have been smaller losses, but the general price level would have risen considerably above planned prices. But the Soviet leaders at first believed that the most important thing was to get their new enterprises into operation; construction and output had to be speeded up regardless of cost. If this raised production costs it was unfortunate, but to raise the selling price of, say, iron and steel in order to enable the metallurgical works to cover their own costs would have upset the financial plans of the tractor works, rolling mills and other industries whose raw material is iron and steel, and thus the whole national industrial finance plan would have been disorganised. Not that this would necessarily have interfered with the production plan, but a general rise in prices would have made it impossible to refute charges of inflation. The principle of rationing was therefore applied to the wholesale exchange of goods between state enterprises and organisations as well as to the distribution of consumption goods to the population. In both cases the would-be consumer, whether a manufacturing enterprise or an individual, was in theory entitled to buy at a fixed price fixed quantities of certain commodities. Money became a mere unit of account. As a measure of value it was practically use-

less if not misleading. If two different articles cost exactly the same sum in roubles to produce, it may be assumed that the same amount has been paid out in wages in the process of manufacture; but if the ration privileges of the workers producing one article were greater than those of the workers producing the other, the real cost of the first must have been greater than the second. In these circumstances there could be no definite relation between the total amount of money, including bank credit, and the total available amount of goods. Had prices been left to the reaction of supply and demand, and maintained at a more or less stable level by a managed currency, it would have been impossible to plan in excess of material resources. Numerous cases are on record where the original plans for an industry or enterprise were revised upward by enthusiastic but ignorant communist directors in order to prove their loyalty without the least regard to possibilities, and supplementary treasury grants to cover the estimated cost were granted without any adequate investigation. In those days of unlicensed planning nearly all the technical experts were *ci-devant* bourgeois who dared not point out the impracticability of the plans for fear of being charged with "wrecking". As a matter of fact their silence too often only deferred their fate, for when the schemes proved impossible to realise they were charged with "wrecking" because they had not protested in the first instance.

It is not known in precise detail upon what system the early planning was conducted. The general outline was described in Chapter V. Theoretically, of course, if the Plan were to be scientifically composed, the distribution of material and labour should have been worked out on the basis of the known available

quantities. But since there was a chronic shortage of material and labour (no one who has made any study of the Soviet Union under the first Five-Year Plan can have failed to read of construction held up through lack of material, the use of inferior local bricks and wood instead of concrete and iron girders because these could not be obtained, factories standing idle because their stocks of raw material had run out, etc. etc.), it can only be assumed that the Planning Committee did not take very seriously the importance of cutting its coat to suit the cloth. On the other hand, it is possible that the Planning Committee did not try to make a careful estimate of the volume of raw material at its disposal, but assumed for the purposes of the Plan that if it awarded a certain sum of money to an industry for capital development, based on the fixed prices of the required material and labour, the industry would be able to buy the material and hire the labour it required. Obviously if prices had been controlled by managing the currency, the funds at the disposal of the Government for capital investment would have been automatically limited to approximately the sum which at current prices equalled the value of the available supply of material resources. But as prices were arbitrarily fixed there was no such automatic equilibrium. Thus enterprises were in somewhat the same position as the individual workers; both received larger sums of money than they could spend on goods at the current fixed price. The result was the same in both cases; the enterprise as well as the individual tried to make up the deficit by purchasing additional goods at enhanced prices on the more or less illegal free market. As an illustration, the woollen textile factories up to 1930 or 1931 were prepared to pay

almost fantastic prices for wool from private growers because the supplies received at the fixed price from the State were insufficient to keep the mills working at full capacity. At that time the Government had not completely organised the collection of all land products and there were still fairly large private owners of flocks in Central Asia as well as one or two foreign farm concessions which could sell direct to state enterprises at any price obtainable. Later the government collecting organisations secured almost the complete monopoly of purchasing agricultural and industrial raw material at the low prices arbitrarily fixed by the Government.

Further instances of the chaotic monetary conditions could be given, but enough has been said to show how it came about that the currency lost most of its power of controlling economic life and how easily the Government must have slipped into the habit of financing its industrial development plans by the device of creating more money and credit when the restraining influence of price movements had been eliminated. There is also one other factor which was examined in some detail in Chapter XV. The real revenue of the Government—that is, the sums collected from the people by way of taxation and loans—consists very largely of the sums paid in direct and indirect taxation by the wage-earners. In a capitalist country taxation means transferring part of the people's claims on goods and services to the State. In other words the State takes for its own purposes the compulsory savings of the people. But the Soviet Government, in the widest sense to include all state organisations and enterprises, both pays the workers' money wages and provides them with the necessities of life at fixed prices. So long as a worker's taxes and other forms of contribution to the

Government did not reduce his money income below the sum needed to buy his rations, the sum received by the Government did not represent any definite purchasing power nor any definite saving. Therefore the Government could not have received a calculable claim over goods and services. Since the average wage, according to official Soviet statistics, increased by 123·5 per cent between 1928 and 1933 while the average output per worker increased only by about 50 per cent, the money income of the workers increased more rapidly than their real earnings. It seems logical to assume on these facts that the average purchasing power of the rouble in 1933 was a good deal less than in 1928. This can, in fact, be proved, for during this interval the fixed ration prices had been very considerably raised, while prices for goods bought outside the ration system were several times higher than the general price level before rationing was introduced. It is therefore not surprising to discover from Soviet records that while the total budgetary revenue rose from R.6650 million to R.40,150 million in 1933—*i.e.* by about 500 per cent—industrial production calculated at the price level of 1926–27 increased from R.19,900 million to R.40,080 million, or by little more than 100 per cent. Even allowing for the fact that saving was far more intense in 1933 than at the beginning of the Five-Year Plan and that savings and investment were in the latter year nearly exclusively centralised in the Union budget, there remains no doubt that, however much prices may have been fixed, the real value of the rouble fell in a manner that definitely connotes inflation.

Since the test of an experiment is how it works, we must try to answer this question in relation to the

Soviet monetary system. The theory that prices fixed on a basis of production costs can serve the same purposes with equal efficiency as prices fixed by supply and demand on an open market has been proved a fallacy. It also seems that when arbitrary price-fixing interferes with a currency's function as a measure of value it also impairs its utility as a costing unit. The Soviet argument is that the value of an article to the community does not necessarily agree with its value as determined by the price obtainable under open-market conditions. In other words the Government, or more precisely the leaders of the community in conference, are naturally better qualified to evaluate the ultimate utility of a project or a commodity than the community as a whole, which unconsciously expresses its opinion by the price it is willing to pay. This theory, carried to its logical conclusion, would mean the abolition of money. The Soviet Government, however, tried to compromise and, while retaining a form of money, attempted to deprive it of its function of expressing the desires of the community by means of price. The result was that the rouble was something more than a labour voucher and something less than a true monetary unit. A Government which pays its employes in labour vouchers must provide the relative goods and services to redeem the vouchers, if not immediately at any rate within a very short lapse of time, otherwise it will openly default against its employes, who will naturally feel aggrieved and lose interest in their work. In fact they would be kept at work only by the alternative of a greater degree of starvation if they refused to work. If, on the other hand, the Government pays its employes in a true monetary currency based on some fixed standard or controlled in such a way that a stable

price level is maintained, it is limited in the amount of money it can pay out by the volume of available goods. Since neither of these restrictions functioned under the Soviet system, the temptation to issue currency in excess was unchecked, and for a time the device of filling up gaps in the material plan by the issue of unbacked currency was recklessly employed. Obviously this could not go on for long without the inevitable consequences. In 1929 the note circulation expanded by 36 per cent, in 1930 by 61 per cent, in 1931 by 29 per cent, in 1932 by 23 per cent, in 1933 by less than 1 per cent. During the same period the net volume of Gosbank credit rose, in 1929 by 40 per cent, in 1930 by 50 per cent, in 1931 by 10 per cent, in 1932 by 0·7 per cent. Subsequently both the note circulation and bank credit again showed sharp rises, but these were due to technical causes connected with the initial attempt to put the whole financial system on a sound footing.¹ The figures quoted indicate that in 1931 the Government or its financial advisers had become alarmed at the enormous expansion of credit and currency circulation and began to take steps to stop the inflation.

§ 2. THE FIRST ATTEMPTS TO REGAIN CONTROL OF THE CURRENCY

As might be expected, the first attempts to re-establish the internal finances of the country were largely

¹ Between 1st January and 1st October 1935 the circulation of Chervonetz notes expanded from R.3838 million to R.4998 million, or by rather more than 30 per cent. This period coincided with the progressive derationing of foodstuffs and increased prices paid by the Government for agricultural produce; in other words, to a perceptible fall in the internal purchasing power of the rouble and a general rise in retail prices.

ineffective because no doctrinaires are prepared all at once to surrender all their theories. The Soviet leaders advanced all manner of explanations to account for the currency expansion and price increases, except the obvious ones. They said that there was no inflationary increase in currency circulation, but a temporary deficiency of goods; even Stalin solemnly averred that the currency was sounder than that of most capitalist countries because it was backed by all the fixed capital assets of the State as well as by gold. He asked, could anybody deny that the rouble was a genuine and potent purchasing medium when it had been successfully used to finance the creation of such enterprises as the Dniepropetrovsk electric works, the Magnitogorsk iron- and steel-works, the Stalingrad tractor works, etc. And so strict is Soviet discipline that not a single Soviet economist even dared to hint at any fallacy in these arguments. Actions, however, are more significant than words, and the professed complacency of the Soviet leaders was belied by a long procession of financial decrees beginning in 1930 and not showing any signs of coming to an end at the close of 1935.

The first important step was the Credit Reform of 1930 abolishing credit between enterprises and concentrating all short-term credit in the State Bank. The idea was that by centralising credit a better control could be exercised; but the new system was inadequately prepared and instead of a contraction there was a marked expansion of outstanding credit. It was also thought that by introducing a system of bank clearing for settling debts between state enterprises and organisations the currency circulation would be decreased, but the reverse actually occurred. The principle

underlying the credit reform was not inherently bad; the faults were that it did not attack the root of the monetary evil and it was ineffectively operated by the bank.

The next move was a decree issued in July 1931 establishing rules governing the working capital of all state economic organisations. This showed some constructive ideas and, coupled with a more thorough organisation of bank credit and improved efficiency on the part of the bank itself, resulted in materially reducing the rate of expansion in currency and credit. But still the root of the trouble was not seriously touched. The financial reforms had succeeded in economising currency and credit through more efficient control, which had as one result an increase in the arrears of wages. Enterprises which, having made unplanned losses, could not obtain additional credit had to carry on somehow, and the only way left was to use their wages funds for other purposes. However, it is more than probable that the pressure exerted by the bank on its clients compelled them to pay more attention to their financial situation. This was called "Control by the Rouble" and gave the bank almost dictatorial powers over industry and trade. One result was constant friction between the bank and its clients, one of the most usual complaints of the latter being that, if for unforeseen reasons a temporary increase in credit was necessary, the bank's red tape prevented its being received in time to do any good. The Soviet newspapers, which freely publish criticisms of the execution of the Plan though forbidden to criticise policy, often contained instances of consignments of goods being returned to the consignor because the consignee had exhausted his credit quota and could

not pay before the following month. It is impossible of course to say in how many cases the bank was justified and in how many the client had a legitimate grievance. But there can be no doubt that the rather rigid regulations governing the bank's credit activities often led to such losses and inconveniences as would result from the temporary holding-up of raw material and the inability of enterprises to lay in stocks of raw material or fuel when transport conditions were favourable, which could have been avoided had the bank been less hidebound.

The conception of a scientific distribution of credit certainly showed real imagination. Its main defect would seem to be the restriction of an enterprise's financial elasticity. A private firm in a capitalist State would find it intolerable if it could borrow from its bank only for a specified purpose and had to justify its application for credit for every specific purpose. But under the Soviet system the supply of material never completely satisfied demand and it was of the utmost importance to eliminate delay in turnover. The detailed distribution of credit made it more difficult for any industrial or commercial enterprise to accumulate and hold stocks in excess of more or less current requirements and thus deprive another enterprise of something urgently required. In the capitalist world the cost of credit inhibits enterprises from locking up liquid resources in unnecessarily large stocks, but in Soviet economy this is not an important consideration. The Soviet attitude is that the commercial profits of individual enterprises are not a true measure of the value of the enterprise to the community. This follows from what was said in the previous section, that the value of a thing to the community is not

necessarily measured by the price the people are willing to pay for it. It does not follow that industrial or trading profits are inconsistent with the Soviet ideology, but profits may not be made by exploiting the consumer; they are only legitimate when they result from the difference between production costs and the fixed selling price of the finished goods. This is quite comprehensible if we try to imagine ourselves in the position of the Soviet Government. As trustees for the whole community it would be our duty to provide the people with the greatest possible amount of the necessities of life at the lowest cost. To do this we should use the available resources of labour and material as economically as possible. The net or divisible profits of all enterprises return to the community through the budget, they do not benefit a small body of shareholders or an individual entrepreneur. But it is only right that the group—that is, the administrative and operating staff of an enterprise—should have some reward if their efforts result in reducing production costs; therefore it was laid down that, when planned profits were realised or exceeded, part of the surplus should be devoted to paying bonuses and premiums and to improve the living, cultural and working conditions of the group. It is difficult to say how far this proved an incentive to the group to try to excel. It may be assumed that when rationing was at its height the prospect of earning a money bonus was a very minor stimulus, for the purchasing power of money outside the ration system was very small.

We have already mentioned the phrase "Control by the Rouble", and this seems rather peculiarly appropriate to the credit reforms introduced during the latter part of the first Five-Year Plan. In the capitalist

world central banks can influence such economic factors as prices, saving and investment by means of their bank rate and by contracting or expanding credit. By these means a central bank can affect profits to a limited extent, but enough to give some direction to the national economy. The Gosbank is powerless to influence Soviet economy as a whole by means of its bank rate, though the idea of employing discriminatory credit rates to encourage efficiency in individual industries or enterprises seems later to have been entertained. But it is obvious that the standard rate can have no effect on production and trade generally. An increase in the rate, other things remaining the same, would simply mean that the national revenue received a larger contribution from the bank and less from the profits of other enterprises. The bank therefore had to make its influence felt more directly, and this it achieved by the system of subdivided credit quotas. It may be more or less in accordance with facts to say that, while capitalist central banks fulfil their functions by holding out inducements to private enterprise to take the desired course, the Gosbank depends more on an element of compulsion to enforce its policy.

In long-term loans or grants for capital expenditure, control by the rouble was found quite as necessary as it was in short-term credit. In the Soviet system when a new enterprise is to be created or an existing one enlarged, the relative combine or trust is granted a sum of money to cover the estimated cost of the work. In most cases actual costs exceeded estimates for a variety of reasons, among which was, not infrequently, the difficulty or impossibility of obtaining all the necessary material at the fixed prices on which, of course, the estimates were based. The responsible organisation had

to decide whether to delay work or try to make up the deficit by buying at a premium. As has been hinted before, in spite of the state control of distribution and prices it is nearly always possible to get what one wants at a price. Since planned estimates almost invariably allowed a quite inadequate margin to cover emergencies, it was generally found that the full grant had been exhausted long before the job was finished. It was not unusual for final construction costs to be 25 to 30 per cent over the estimates. In a capitalist State costs are automatically kept down because the entrepreneur knows that he will have to pay interest on the capital subscribed. Under the Soviet system, as was explained in Chapter X, non-repayable and non-interest-bearing grants are made for the construction of state enterprises so that no question of repayment and interest arises. It is true that every enterprise is supposed to set aside from its revenue each year a certain sum for amortisation, but this, as far as is known, has no direct connection with the original construction costs. Eventually the method of paying out capital grants was modified, so that, instead of the constructing enterprise receiving regular monthly or quarterly instalments in advance, it received periodical payments based on the value of the work that had been completed during the preceding period, calculated according to the authorised prices for material and cost of labour. This system involved the issue of short-term credit, either to the constructing enterprise or to the contracting enterprises, to finance the work until the next instalment of the capital grant was due. If estimates were exceeded, the short-term credit could not be entirely repaid and a part became frozen.

Control by the rouble as adopted in connection with

short-term credit and long-term capital funds brought about a certain improvement, or at least was accompanied by some improvement, for it is difficult to say how far increased industrial efficiency and the better and more economical use of material and labour were due to the bank's financial measure or to growing experience and more rational organisation on the part of the industrial and commercial administrative heads and technical staffs. There is no doubt that the return to single authority and responsibility and the higher material rewards held out to those who showed the best results were also an important factor in the genuine economic improvement that began to appear in 1933 or 1934. It would, of course, be quite wide of the mark to assume that the Soviet system, so far as industry, agriculture and distribution are concerned, is comparable in efficiency and organisation to Western industrial States. But it would be unfair to dismiss this without qualification as the inevitable result of socialism. No system could create an enormous industrial structure from next to nothing in a few years and make it work as efficiently as industries that had been gradually developing for fifty to a hundred years. Experience nevertheless proved emphatically that the initial attempts to administer big undertakings on communist lines, that is on a collegiate system, were doomed to failure. At one time every worker in a factory had some say in the management if only through the works committee; but this principle was soon dropped in practice, and by the beginning of the second Five-Year Plan the administrative organisation and labour discipline in Soviet enterprises differed little from private enterprise in capitalist States.

§ 3. DERATIONING AND OPEN MARKETS

At the beginning of this chapter it was stated that rationing should not be arbitrarily condemned as a failure. It is very doubtful whether the Soviet Government would have been able to save in any other way so large a proportion of the national income. But rationing, and by this is meant not only the supply of consumable rations to the masses but the planned distribution of material to industry at fixed prices, showed defects; it led to waste because every consumer, individual or enterprise, made a point of buying up to the last unit of the goods they were entitled to purchase at the fixed prices because these prices were lower than the natural market price. If goods bought at ration prices were not required by the purchaser for his own consumption he could always resell (illegally) at a profit or barter away in exchange for something else; it probably also contributed to over-planning, because so long as the Planning Committee only recognised fixed prices there was nothing to show that its estimates of material exceeded the real quantity available until construction and production began to lag behind the Plan owing to shortage of supplies. Under open-market conditions rising prices would have afforded a much more sensitive as well as earlier sign of over-planning. Added to this was the fact that the various price systems impaired the reality of cost accounting and caused all sections of the community, including enterprise administrators, to lose confidence in and respect for the currency.

The Soviet leaders, probably under the urgent advice of their economic experts, gradually came to recognise and acknowledge the defects of rationing. Of course

rationing was avowedly introduced in 1929 only as a temporary measure. According to the programme it should have become unnecessary at the end of the first Five-Year Plan when retail distribution should have reverted to open selling at about the same prices as under rationing; but by the end of 1932 natural price levels had risen so far above the artificial ration level that a sudden change to open-market retail distribution was utterly impossible. It would have created complete financial chaos.

In 1931 the Government opened a few commercial shops in the biggest towns mainly, it may be imagined, to provide some outlet for the surplus money of those in receipt of high money incomes. Commercial shops proved a success, and it must soon have dawned on the Government that here was a solution of the difficulty how—when the time was ripe to change back to the open market—to soften the shock of a sudden rise in prices. By 1932 at the latest it had become obvious that the fall in the purchasing power of the rouble was permanent and that a much higher general price level would have to come sooner or later. If the population could be persuaded to buy an increasing proportion of its requirements on the commercial market it would become accustomed to the idea that ration prices were really very moderate. As the supply of goods on the commercial market increased, prices were gradually lowered; at the same time ration prices were by degrees raised and rations quantitatively reduced.

In 1934 it appeared that the time had come when a beginning could be made with derationing. The supply of available food and consumption goods had definitely turned the corner and was steadily, if slowly, expanding; practically the whole population had been

drawn into the social system, as state employés, workers in state enterprises, including the co-operative system, and as members of collective farms. The remnants of private enterprise were not important enough either financially or numerically to make any appreciable difference to the demand for consumption goods. Thus one reason for rationing—to secure the lion's share of available goods to those who had a claim on the State and exterminate private enterprise—had vanished. A positive reason for abolishing rationing was the cost of the system, said to amount to about R.8 a year for every ration card issued, or a total of some R.300 million a year. Rationing had, too, always operated against differential wages. It is easy to understand how, under a system of rationed distribution, the advantages accruing to a high money income are largely negated. It is a simple matter to satisfy the needs of the uneducated, low-paid manual worker, who expects little from life but food, clothing and shelter; but the educated engineer, scientist or administrator has all sorts of intellectual and cultural desires which cannot well be satisfied under a rationing system. When the principle of payment according to qualifications and ability had been officially adopted, it was desirable that no artificial restrictions should be imposed on the way the individual spent his income. A start was made with derationing bread and most cereal foods on 1st January 1935. On 1st October 1935 practically all foodstuffs were derationed and only a small portion of cotton and woollen goods, clothing, leather and rubber footwear, cigarettes and soap were still sold at ration prices. No doubt these exceptions were necessary because the open-market prices would have been too high for the lower-paid industrial

workers, whose expenditure on food had already been materially increased when they had to obtain all their needs at open-market prices. The new open-market prices were nominally fixed by the Government, but obviously they must have been fixed with a view to equalising supply and demand.

The return to open-market conditions in retail trade brought about a further important change in the relations between the community and the State as supplier of consumption goods. As soon as fixed ration prices were abolished, prices began to reflect the intensity of popular desire for any given commodity. But while in capitalist States a rise in the price of any commodity, if due to a rapid increase in demand, is soon countered by increased supply, this is not a matter of course in the Soviet economic system. It might happen that a very pronounced rise in price would induce the Government to increase the planned output of that particular thing during the next planning period, but the rise in price exerts no automatic stimulus on production because the manufacturing enterprise sells to the distributing enterprises at a price based on production costs, the additional profit caused by the rise in price being appropriated by the Government. There is no addition to the profits of the retailing enterprise, because the retail selling price consists of two parts: (1) the planned portion which covers the fixed wholesale price plus the planned costs of the retailing enterprise plus a fixed percentage for profit, and (2) the additional sum that has to be added to the first amount in order to equalise demand and supply. The second part is paid direct into the budget. The bulk of the budget revenue (nearly 87 per cent in 1934) is derived from the difference between production costs

and selling price. This difference is for practical purposes a monopoly profit accruing to the Government in consequence of its position as sole supplier of consumption goods to the people. It may be argued, because the word "monopoly" connotes exploitation it should not be used here, for in theory at least there is no private gain; that is, no exploitation of one group or section of the community by another. But this is beside the point, which, so far as we are concerned, is the absence of competition, which among private enterprises tends to keep profits within certain limits.

At the time of writing (December 1935) it remains to be seen how far the Soviet leaders intend allowing prices to affect production, especially if the result is to conflict with the Plan. It may at least be assumed that the decision regarding the allotment of the country's resources to increasing fixed capital and to producing for consumption will remain a government function for a long time yet. At the same time it would be surprising if the open-market principle was not in due course extended to wholesale trade. There is no insuperable difficulty in allying planning with an open-commodity market when the planning authority has absolute control of all saving and investment and so long as demand for consumption goods can be restricted by including a high incidence of taxation in the retail selling price. A prerequisite to planning entirely on a monetary basis is a stable price level. The difficulties, if not the impossibility, of correlating production planning and financial planning when neither plan is definitely subordinate to the other, the only link being provided by arbitrary fixed prices, has been demonstrated. If a stable price level is to be maintained so that the grant of a given sum of money for investment

purposes confers on the recipient industry, without any question, the power to obtain a definite quantity of goods, services or labour, the currency and credit policy of the Gosbank must be determined by the flow of available goods. Since the production costs of all commodities is the result of successive applications of labour, it would seem that the first task must be to establish a more or less constant relation between wages and the productivity of labour.

One of the causes of the upward tendency of prices was the more rapid increase in wages than in output. Official Soviet statistics show that between 1928 and 1934 the "wages fund", that is the total sum paid out in salaries and wages to all state employés and workers, including those employed in state and co-operative enterprises, increased from R.8159 million to R.41,604 million—that is, by about 410 per cent—while the output of large-scale industry, measured in roubles at prices ruling in 1926-27, increased from R.16,891 million to R.50,002 million, that is by about 196 per cent. The increase in wages and salaries paid to officials and workers in industry alone increased by about 361 per cent. In such circumstances any attempt to maintain a stable price level must be in vain, and it follows that if the Soviet leaders are determined to establish a stable price system the price of labour must first be stabilised.¹ The problem of wages has two aspects; the production costs of all commodities depend upon the aggregate cost of all the labour that has gone into their manufacture. Wholesale prices, therefore, depend mainly on the cost of labour, for even if the open market

¹ A very similar problem is considered in "The Control of Wages in War Time" in *The Problem of Industrial Relations*, by Henry Clay Macmillan, 1933.

be extended to wholesale trade, the monetary and credit policy of the Gosbank can prevent major fluctuations in demand. Retail prices are, however, bound to be much higher than wholesale prices so long as so much of the country's national income is invested in creating fixed assets. The more scientific method of adjusting money incomes to the supply of consumption goods would be by direct taxation. Sooner or later it will be possible to reduce the rate of saving and increase the output of consumers' goods in relation to the output of producers' goods; and if the retail price level has been kept constant by taxing incomes, demand can be adjusted to increased supply by reducing the incidence of taxation without interfering with prices. On the other hand, if demand is restricted by raising prices, the eventual adjustment must be effected by lowering the price level as supply expands.

The great increase in both aggregate wages and the average annual wage income (156 per cent between 1928 and 1934) points to the demand for labour having steadily increased rather faster than supply, in spite of the fact that there was no genuine free labour market. Under a free labour market, which would naturally accompany or follow a free commodity market, the demand for labour would be brought into equilibrium with supply in much the same way as the demand for material. So far as capital industries are concerned, the demand for labour as well as for material would be governed by the amount of money or the proportion of the national revenue set aside for capital development. The demand by consumers' industries would depend on the demand for their products which would be determined by the effective purchasing power of

money incomes; that is, the purchasing power left after the compulsory saving as decreed by the Government had been made. The natural level of wages would be that which resulted in an average money income just sufficient to enable the average citizen to purchase an average share of the total flow of available consumption goods. Under a system of price maintenance by currency management the natural wage level would emerge of its own accord as the result of the interaction of supply and demand.

§ 4. CONCLUSIONS AND FORECASTS

Under the forced economic development of the first Five-Year Plan and the first half of the second, the Soviet financial experiment did not have an entirely fair trial. During a war abnormal strains are put upon a capitalist currency, which the history of the past seventeen years shows are liable to end in some form of devaluation following a period of inflation. Since 1928 the economic situation in Russia has been very similar to that accompanying a war. An abnormally large proportion of the country's resources were devoted to building up industries capable of providing all the munitions and material of war that would be needed if Soviet Russia became involved in a first-class European war. And these industries were not only created, but were put to manufacturing munitions of all sorts in large quantities. It is therefore not altogether surprising that the currency showed all the symptoms of inflation. But there emerged other defects independent of mere inflation. These can be summed up by saying that the rouble could not be made to serve as a standard measure of value. That this was the major fault

from the view-point of the Soviet Government was indicated in many utterances by government spokesmen and the stress laid on the intention to "strengthen" the rouble, which somewhat vague term may be taken to mean stabilising the currency in terms of commodities and giving it a decisive rôle in controlling production and distribution. The first step was naturally to do away with the rationed distribution of consumers' goods. The fact that the new single prices were fixed by the Government and that these prices were not the same for the whole country, but varied in the eight zones in which the country was divided, is sufficiently accounted for by the confusion that would have arisen if the retail organisations had been allowed to fix their own prices. Without competition between rival enterprises there is little inducement to lower distributing costs and reduce prices to the lowest level necessary to restrict demand to supply. But with the abolition of rationing the public gained the privilege of buying at any shop, and since every trading organisation must maintain a planned rate of turnover, competition is bound to arise, if not in prices, in the matter of service, quality of goods and the cleanliness and general attractiveness of the premises. This form of competition was in fact specifically recommended by government spokesmen and in the newspapers. It is possible that when the idea of competition on these lines has been assimilated, some latitude will be allowed in the matter of price.

As regards wholesale trade a small breach was made in the price-fixing principle early in 1935 when the sale of tractor spare parts to the state farms and Machine Tractor Stations was put on a commercial basis. So long as the manufacturers' selling prices were arbi-

trarily fixed it was bound to happen that it paid better to produce some types than others irrespective of the demand. This, in fact, has been the case in many industrial enterprises producing a variety of articles or specifications, and so long as demand was not reflected in price there was no corrective to the over-production of some things and the under-production of others. For this reason alone a policy of allowing demand to influence supply by means of price is likely gradually to supersede purely arbitrary price-fixing. This will mean a large degree of decentralisation and increased financial independence of economic organisations. At the close of 1935 the economic policy of the Soviet Government was already evincing a strong tendency in this direction; for instance, it was announced that the managers of state farms, who previously had to carry out the plans allotted to them by their trust or combine, were to run their farms on commercial—that is, on profit-making—lines and were granted far greater discretion both in their internal organisation and external commercial relations with other enterprises than they had ever had before. At the same time a large number of the state farm trusts and combines were dissolved and the farm directors made directly responsible to the competent department in the Commissariat of Agriculture, which concerned itself only with broad outlines of policy.

While internally the Soviet rouble currency at the end of 1935 was making rapid progress (possibly retrogression would be more apt) towards capitalist orthodoxy, it showed no desire to open relations with other currencies. In view of the fact that foreign trade is a strict government monopoly and that the condition of most capitalist currencies left a good deal to be

desired, there were no solid reasons to abandon isolation. There is no difficulty in conducting foreign trade in terms of an imaginary gold unit, such as the gold rouble which serves as a common denominator for converting other currencies; the chief drawback is the impossibility of calculating by this standard the utility of importing one article rather than another or of exporting a given commodity to import something else. But until the internal commodity value of the rouble has been finally stabilised, it would be impracticable to fix any exchange rates that would serve to correlate internal rouble prices with the price in foreign currency received for exports. No doubt in due time either the paper rouble will be fixed as a definite fraction of the gold rouble or a new gold content will be given to the paper rouble, but there would seem to be no advantage in this before a general restabilisation of world currencies.

Meanwhile some means had to be devised for allowing foreign tourists and visitors to pay their way. Up to 1931 foreigners had to exchange their own currency for roubles at the official rate fixed by the Gosbank. This was determined by the nominal gold content of the rouble and the gold value of the foreign currency. But when internal paper rouble prices began rapidly to rise, the cost of living for foreigners became prohibitive and, rather than lower the exchange rate, the Soviet Government preferred to institute a system by which foreigners could pay in their own currencies. In the hotels for foreigners and in the Torgsin shops prices were quoted in gold roubles, payment being effected in foreign currency converted at the official rate. Gold rouble prices in the Torgsin shops varied roughly between one-fifth and one-tenth of the paper

rouble prices for similar articles sold in the commercial shops. This system lasted till the end of 1935, but it was inconvenient and cumbersome and also led to the formation of a black exchange market on which paper roubles could be bought at a small fraction of their official exchange value. At the close of 1935, in view of the abolition of rationing and the sale of nearly all retail goods at universal prices, most of the original motives for segregating foreigners into the so-called "Valuta" system had disappeared, but since paper rouble prices were still several times higher than gold rouble prices it was out of the question to make foreigners buy roubles at the official rate. To do so would have stopped at one blow the tourist traffic, which is a by no means negligible item in the Soviet's balance of payments. In November 1935 a decree was issued providing that after the New Year all foreigners living in or visiting Russia must pay their way in roubles which they were to be allowed to purchase inside the country at a rate of R.1 = 3 French francs. This amounted to a depreciation of about 77 per cent on the former official rate of R.7.50 = 100 francs. All the same, even with this devaluation the cost of living in the U.S.S.R. based on the new single prices for staple foodstuffs was much higher for most foreigners than at home.¹

It was specifically explained that this reduced exchange rate was merely a concession to foreigners and did not mean an official devaluation of the rouble. So far as concerns external trade and foreign financial relations, the old gold parity rate would remain in force for statistical purposes.² It was implied that the new

¹ See Appendix for food prices.

² By a decree of 29th February 1936 the new rate was entirely to supersede the former official rate from 1st April 1936. This amounted

rate at which foreigners were to be allowed to buy roubles was only a temporary measure. Since it is the expressed intention of the Soviet Government further to lower prices before attempting to establish a stable price level, the rate was probably fixed to allow of a subsequent fall in prices, though it was clear that if retail prices remained about the level ruling at the end of 1935, the cost of a visit to Russia would be very considerably higher in 1936 than in 1935 under the "Valuta" system.¹

The decision to return to a rouble basis, at a devaluation, for retail trade with foreign visitors is interesting as showing that the Soviet Government at last has recognised a *de facto* depreciation of the rouble. This is the first step towards a breach in the barriers which enclosed the Soviet currency and towards linking it up with world exchanges. Whether the Soviet rouble will ever be dealt in on international bourses cannot yet be foreseen, but the path travelled by the rouble since the beginning of 1935 has shown a remarkable convergence towards orthodox capitalist principles. Even as politically the Soviet Government is visibly tending to become more democratic as the younger dictatorships become more despotic, so Soviet economic theory may soon be considered reactionary by the advanced advocates of social credit schemes and the manipulation of credit in Western countries.

to devaluation, since after that date the gold stocks and foreign exchange holding of the Gosbank were revalued at the new rate. But this made no difference to the internal purchasing power of the rouble.

¹ Foreign tourists, however, are still allowed to purchase tickets, hotel coupons, etc., for the official conducted tours at the foreign offices of Intourist (the Soviet tourist agency) at the former rates.

APPENDIX

THE PURCHASING POWER OF THE ROUBLE IN RETAIL TRADE

THE complete abolition of rationing from the beginning of 1936 makes it possible to arrive at a rough estimate of the purchasing power of the present rouble as compared with the pre-War rouble.

The great area of Russia (involving rather more intense transport problems than in Western Europe) and the greater dependence of the population on local products and markets has always caused considerable variations in prices in different districts. Although the abolition of rationing did away with the differences between rationed and commercial price levels, the new single retail prices vary very considerably in the various price zones into which the country is divided. Any list of retail prices can, therefore, only represent an approximate average for the whole country.

The single prices in 1936 are from fifteen to twenty times higher than in 1913. In 1913 the average industrial wage was some R.25 to R.30 per month; in 1935 the average wage of all industrial employ es was about R.170 per month. Money wages in 1935 were thus six to seven times higher than in 1913. Actually this figure is too high, because the 1913 figure applies only to factory workers while the 1935 figure includes the salaries of the administrative and technical staffs. Though money wages in 1932 were about 30 per cent less than in 1935, it would seem that the purchasing power of wages in 1932 was higher than in 1936, but the ration of the average worker did not satisfy his full requirements and commercial shops had only just begun to appear in two or three of the biggest towns. The average citizen, therefore, had to supplement his purchases in state and co-operative shops by buying at very much higher prices on the free market.

The following table (in kopeks per kilo) shows the average retail prices of some of the most important foodstuffs in 1913, in 1932 and in January 1936:

	1913	1932		Jan. 1936
		Rations	Commercial Shops	Prices in Moscow
White bread . . .	10	15	..	170
Rye bread . . .	5	6	..	85
Wheat flour . . .	12	180
Rye flour . . .	7	160
Rice . . .	27	650
Millet . . .	10	30	100	210
Buckwheat meal . .	17	35	110	430
Butter . . .	115	365-466	1400-1800	1400-2000
Sunflower-seed oil	32	170	500	1300
Sugar, granulated	29	95	250	380
„ lump . . .	34	125	300	410
Beef . . .	50	212	600	760
Eggs (10) . . .	25	100	400	650
Milk (litre) . . .	10	..	100	160
Potatoes . . .	6	..	100	30

The Soviet Government has not published any price indices showing the comparative purchasing power of the rouble since 1931, therefore it is only possible to make rough estimates on the data available. It would probably be not far from the facts to put the purchasing power of the rouble in 1936 in respect of the most important articles of consumption at $\frac{1}{8}$ of the 1913 rouble, or, taking into consideration housing rents, travelling, etc., at $\frac{1}{2}$ of the 1913 rouble.

A decree issued on 29th February 1936 ordained that on 1st April the exchange value of the rouble for all purposes in which a conversion rate is needed was to be fixed at R.1 = 3 French francs. Since the introduction of the chervonetz in 1922 the theoretical gold rouble had a gold content of 0.774 gramme of fine gold which gave approximately an equivalent of R.1 = 13.33 francs. This devaluation of the exchange value of the rouble could have no effect on the internal price level, but it

affords a basis for comparing the purchasing power and cost of living in Soviet Russia with the United Kingdom.

The average wage and salary income of all state employes in 1935 was about R.2050, and, allowing for a 10 per cent increase, may be put at R.2250 for 1936. At the official rate of R.1 = 3 francs, £1 is equal approximately to R.25, therefore the sterling equivalent of the average Russian wages income would be £90 or about 35s. a week. The average wage of an adult working man in London when fully employed is about 63s. a week. The comparative purchasing powers of the rouble and pound may be estimated from the following figures showing the sterling equivalent of current rouble retail prices and the current retail prices of similar articles in England:

APPROXIMATE PRICES PER LB. IN SHILLINGS AND PENCE

	Moscow	London
	s. d.	s. d.
White bread	0 7	0 2
Wheat flour	0 8	0 2
Rice	2 6	0 3
Oatmeal	0 6	0 3
Beef	2 10	1 2
Butter	6 4	1 2
Sugar	1 9	0 3
Potatoes	0 1½	0 1
Herrings	1 8	0 6

The Moscow prices are four to five times higher than the London prices. In other words, R.25 in Moscow will not purchase anything like as much food as 20s. will buy in London, but only about as much as 4s. or 5s. While the average Russian wage is only about 56 per cent of the London working man's earning in terms of money, its purchasing power, so far as food is concerned, is only some 14 per cent. The average Russian, therefore, can buy with his week's wages about as much food as the Londoner can buy with 9s.

While the retail cost of food increased during the Bolshevik régime till it was many times higher than before the War, the

prices received by the peasants for their produce showed a very modest rise. The following table shows the average prices obtained by the peasants in 1913 on the open grain market and the prices paid by the Government for compulsory deliveries of grain in the years 1927-28 and 1932-33:

	Kopeks per 100 Kg.		
	1913 ¹	1927-28 ²	1932-33 ²
Rye	447	458	633
Wheat	568	794	852
Oats	361	429	560
Barley	372	425	642
Maize	366	390	544
Sunflower seeds	641	784	880

On the basis of these figures, in 1927-28, the last year before the first Five-Year Plan began, the peasants, at least those engaged mainly in producing grain, received about 18 per cent more money per unit of grain sold than in 1913. Since the total grain crop of the 1927 harvest was not equal to the pre-War average, the peasants' total money income must have been less than 18 per cent above pre-War; but the retail price level for manufactured goods was more than twice as high as in 1913. In 1932-33 the fixed prices for grain deliveries were, on an average, about 50 per cent higher than in 1913 and 30 per cent higher than in 1927-28. It is true that the peasants could sell their surplus on the open market at much higher prices, but after fulfilling their compulsory deliveries and setting aside grain for seed and for their own consumption, the balance remaining was not very large. The retail price level in 1932-33 was for the peasants more than five times higher than in 1913, for they had far less possibilities than the town proletariat in buying manufactured goods at moderate ration prices. Therefore, even if they obtained twice as high a monetary return for their crops, their purchasing power was not more than half

¹ *Bulletin of Slavonic Institute, Prague, May 1933.*

² *Soviet Statistical Year-book, 1932. Average of prices in the Central Black Earth Region and the Ukraine.*

what it had been in 1913, and probably even less. While the index of the peasants' money income was more or less as follows:

1913.	1927-28.	1932-33.
100	118	(say) 175

that of the industrial workers was:

1913.	1927-28.	1932-33.
100	290	490

from which it may be deduced that the "saving" needed to finance the Soviet's industrialisation programmes fell more heavily on the peasants than on the industrial proletariat.

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