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Chapter Title: Stabilization Policy and Monetary Equilibrium

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## Stabilization Policy and Monetary Equilibrium

### *Sources of Inflationary Pressure*

OVER the years, Soviet economic policy has had to deal with a wide range of macroeconomic problems, some of which are similar to those encountered in Western economies. Repressed inflation is one of these, arising from excessive money creation.<sup>1</sup>

The opening of an inflationary gap in the consumer sector may be due to one or several of the following main causes: faulty planning, crop failures, bottlenecks in the flow of materials into consumer goods industries, excessive immobilization of resources in unfinished investment projects, transportation difficulties, and insufficient or defective storage facilities. Such phenomena unbalance the equilibrium between the flow of purchasing power to consumers and the availability of goods provided for in the economic plan. The concentration on goods was justified until recent years because the flow of purchasable services to consumers was very small.

Students from noncommunist countries have been almost exclusively interested in the effect of inflation on the real wages of urban wage earners. Yet, until 1960 the rural population was larger than the urban population, and twenty years earlier it had been twice as large.<sup>2</sup> Another source of inflationary pressures is the excessive immobilization of resources in unfinished major

<sup>1</sup>The term "inflation" is banned from the Soviet vocabulary in relation to the domestic economy.

<sup>2</sup>In the smaller socialist countries the importance of services is greatest in part because some services are supplied by the private sector.

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capital investment projects.<sup>3</sup> During World War II, another major problem was the accumulation of money in the hands of the agricultural population. This was the unavoidable consequence of several factors: the efforts to achieve maximum availability of farm products in the face of a huge manpower drain; the almost total lack of industrially produced inputs in agriculture, and the general disorganization as the invading armies swept back and forth across the main producing areas of the country.

In the enterprise sector, fixed transfer and end-product prices for producers' and consumer goods, together with the attached administrative controls, have sharply limited the ability of managers to use enterprise balances outside of the legitimate planned channels.<sup>4</sup> Lower-echelon administrative units can obtain funds mainly via the national budget; other sources are marginal.

The fact that the unified budget has always been in balance or shown a surplus (except for one or two war years) eliminates a possible source of inflationary financing which is significant in some nonsocialist countries. However, enough outside pressures from industrial ministries, *glavks*, and various federal and republican authorities converge on the State Bank to result, at times, in excessive credit issuance, prolongation and renewal (if necessary, in disguised form) of loans outstanding, and undesirable over-expansion of currency in circulation.<sup>5</sup>

### Policy Objectives

The objectives of Soviet financial policy are essentially twofold: to achieve macro equilibrium in the enterprise sector by securing adequate financing to cover the planned volume of investment,

<sup>3</sup>See Brzeski [222].

<sup>4</sup>The Soviet government has not used the various techniques developed in other socialist countries to deal with excess liquidity. Such techniques include the temporary blocking of some part of enterprise accounts (Poland), creation of credit cooperatives in which some part of money held by farmers is immobilized as the members' capital contribution (China), and advance deposits (usually in special savings bank accounts) for cars (Czechoslovakia), cooperative apartments, or imports.

<sup>5</sup>This contrasts with the experience of other socialist countries of Eastern Europe, where overspending by state enterprises and operations of the remaining private enterprise sector have occasionally constituted important sources of inflationary pressures. See, for instance, Podolski [139].

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In the enterprise sector, “financial balance” is achieved when budget resources available for investment plus retained enterprise profits earmarked for this purpose match planned investment requirements in excess of available depreciation reserves. Equilibria consistent with quite different allocations of resources and rates of growth may be achieved at various levels by successful manipulation of taxes, prices, and credit.

In the household sector, the main objectives of financial policy are to avoid inflationary pressures, both overt and repressed, in the consumer goods market and to prevent consumers from becoming excessively liquid. This must be viewed against the background of the inelastic supply of consumer goods resulting from the forced-draft industrialization since the inauguration of the first Five-Year Plan in 1928. Since the early thirties, banking policy has aimed at preventing loan expansion from raising currency withdrawals above the total value of any additional consumer goods and services the economy is capable of producing.

While overall economic strategy at different times has involved the use of available policy tools in a variety of combinations, Soviet sources (official as well as academic) hardly ever discuss its rationale and actual application.

### *The Tools*

In order to achieve policy objectives, the main reliance is placed on the monobank-monobudget system which was created in the early thirties and was a pioneering move by the first socialist country to provide an optimal financial structure for stimulating planned economic growth under conditions of reasonable monetary equilibrium. The various methods that have been used by the Soviet Union to achieve macro equilibrium can be classified into categories corresponding to those common in the noncommunist countries: monetary, fiscal, and income policies. The first includes credit planning and regulation of currency circulation. The second consists essentially of variations in planned budget surpluses and their use, government borrowing, and changes in

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tax rates (mostly the turnover tax on individual products). The third, income policy, involves, in the broadest sense, determination of the share of the national product earmarked for household consumption, with administrative changes in wage policy and allocation of resources and, if necessary, mid-stream adjustments in five-year plan targets.

The above classification of economic policies is subject to the qualification that many aspects of fiscal policy have, in fact, significant monetary aspects, while others, such as the manipulation of the turnover tax on individual products, are an important element in price formation and, therefore, in income policy. Policies pursued to cope with chronic shortages of consumer goods have included efforts to increase the flow of such goods above the quantities originally planned by "overfulfilling" the plan, to adjust the composition of industrial output between producers' and consumer goods, and to change the "assortment" of products available to households. Since the mid-fifties, measures to increase the supply of consumer goods to relieve inflationary pressures have also included limited encouragement of private production by members of *kolkhozes*, fuller use of by-products and industrial remnants in consumer goods production,<sup>6</sup> and allocating an increasing share of foreign exchange earnings for consumer goods imports (primarily from other socialist countries).

#### MONETARY POLICY

Even though in the Soviet economy money is reduced to the function of "numeraire" and isolated from influences of the balance of payments as well as from fluctuations in domestic gold production, it is nevertheless a necessary ingredient of a centrally controlled (or administrative) economy which is too complex for barter and direct distribution of goods to consumers via a voucher system. Soviet monetary policy encompasses basic arrangements

<sup>6</sup>Failure of the flow of consumer goods to match the increase in money income due to delays in completing new factories or to the accumulation of finished goods in factories may also involve bank action. However, prior to the Reform, the failure of financing for a specific project to reach the planned amount would normally lead to interruption of construction or allocations of additional funds from some reserve pool of investment funds (at the disposal of some ministries) rather than to credit financing.

(the separation of currency circuits, for example) and longer-range decisions (such as working capital norms and credit planning), rather than day-to-day activities designed to influence aggregate demand, as already discussed in Chapters 3 and 6. It is thus more appropriate to speak of monetary strategy than of monetary policy, and assign it the role of an organic component of the planning process rather than that of an independent tool for influencing current economic activity. Monetary policy in the Soviet Union is, in fact, limited to controlling the aggregate amount of currency (household money), the volume and structure of credit, and the level of enterprise balances. It plays hardly any role in setting investment priorities or in achieving increases in productivity and affecting the transfer of human and material resources between industries and regions.

Although one can identify at any one time the general objectives of the State Bank's credit and note-issue policies, it is difficult to tie these separate aspects into something that would add up to a "socialist monetary policy." Western views on Soviet monetary policy depend on a number of things: the period considered; the definition of what constitutes monetary policy (for instance, whether manipulation of the budget surplus constitutes monetary policy); whether price setting is considered a "monetary means," as Holzman proposes;<sup>7</sup> and whether one believes that price stability is an absolute priority, or, as Hodgman claims, that authorities are only concerned with achieving a degree of price stability consistent with a desired rate and pattern of output growth.<sup>8</sup> Montias holds that the role of the monetary and financial system is limited to assuring that material plans can be carried out without financial impediments.<sup>9</sup> Most Western economists agree with Powell that Soviet monetary policy has no quantitative objectives; at best, the Ministry of Finance and the State Bank can take post-factum actions to correct their collective mistakes.<sup>10</sup> Others believe with Pickersgill that "an economy in which goods and services are exchanged for money and in which

<sup>7</sup>[131], p. 130, f. 1.

<sup>8</sup>[122], p. 108.

<sup>9</sup>See Chapter 3, footnote 5. This is the conclusion of Montias with regard to Poland; see [118], p. 56.

<sup>10</sup>[140], p. 1.2a.

workers are paid an implicit money wage that "nonmonetary" based on monetary equilibrium does not mean

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<sup>11</sup>[138], p. 217.

<sup>12</sup>Ames [99], p. 1.

<sup>13</sup>See, for instance

<sup>14</sup>In Holzman [12] point in [252].

workers are paid in units of generalized power" will have at least an implicit monetary policy.<sup>11</sup> Ames makes the additional point that "nonmonetary measures" may and, in fact, frequently are based on monetary analysis and aim at the preservation of monetary equilibrium, so that the fact that a remedy is "nonmonetary" does not mean that it has no "monetary" aspects.<sup>12</sup>

Neither the degree to which overall targets have been achieved nor shortcomings in certain areas of the economy and in individual industries can be traced directly to the financial system in general or its monetary aspects in particular. Yet the question has been raised whether monetary policy, although passive, might not have contributed to achieving the goals set by planners.<sup>13</sup>

Soviet monetary policy focuses on the flow of consumer purchasing power rather than on the total stock of money. With prices set administratively and the scope for fluctuations in currency turnover minimal, Soviet monetary policy operates, in fact, on the basis of what Hodgman has called "an inverted equation of exchange" by adjusting M to T.<sup>14</sup> One problem is to determine in which way control of money to absorb and sterilize excess purchasing power is shared between the State Bank and the budget.

Maintenance of equilibrium in the consumer market is greatly facilitated by the physical and operational separation of consumer money from enterprise money. The proper growth of currency in circulation is one of the "proportionalities" claimed to be a keystone of Soviet planning. This increase is determined within an implicit analytical framework that is not unfamiliar to Western economists. The rise in consumer disposable income projected from the planned growth targets for GNP at a planned (normally unchanged) price, after allowing for projected voluntary savings, yields an estimate of the required increase in currency in circulation, assuming stable velocity. If the flow of consumer goods and services cannot be increased correspondingly, inflationary pressures will develop as currency accumulates in the hands of consumers. If spendable income cannot be reduced sufficiently,

<sup>11</sup>[138], p. 217.

<sup>12</sup>Ames [99], p. 172.

<sup>13</sup>See, for instance, Wiles [253].

<sup>14</sup>In Holzman [122], p. 123. Earlier, the Hungarian economist Varga made the same point in [252].

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credit to the economy must be cut, if budget surpluses, deposits held by enterprises and collective farms, household savings, and such minor potential offsets as profits of the State Bank cannot absorb the excess currency. It is in this sense that the "planned" increase in circulation "determines" the volume of credit, a statement that is frequently found in Soviet literature and one that, to Western economists, appears to put things upside down. Constant official emphasis is on limiting credit and maintaining levels of circulating currency that neither push *kolkhoz* market prices far above official food prices nor produce persistent consumer goods shortages and queueing.

In addition to limiting currency in circulation, the basic objective of bank policy is to offset any changes in the velocity of household cash which may result from dishoarding, usually as a result of precautionary buying in anticipation of shortages.<sup>15</sup> When the level and distribution of spending do not conform to the underlying plans, only minor remedial action can be taken by the State Bank through administrative improvisation.

If excessive issuance of credit produces redundant balances in the accounts of the state-owned sector of the economy—in addition to or instead of an excessive flow of purchasing power to households—the problem is tackled by administrative intervention, either by transferring cash balances among individual enterprises (thus obviating the need to borrow by some of them), or by speeding up loan collection.

Holzman, who authored the most detailed study of the period from the start of the first Five-Year Plan in 1928 to 1957 credits improved direct bank controls over aggregate payroll expenditures rather than deflationary monetary and fiscal policy for the considerable easing of inflationary pressures after World War II.<sup>16</sup> Other Western students of the Soviet economy view the post-World War II decline and ultimate stabilization of prices, accompanied by a decline of free-market prices relative to official prices, as the result of a "fully-administered price decline" rather than a monetary deflation.

<sup>15</sup>Given the low level of financial savings until the middle sixties, surges in the velocity of currency due to dishoarding or withdrawals from savings accounts have never assumed large proportions. Concern with variations in velocity and attempts to study its determinants go back to the early thirties.

<sup>16</sup>[240], p. 188.

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## FISCAL POLICY

Budget policy has been a key element in Soviet financial policy. The various aspects of this policy involve not only decisions about the level of the budget and the size of planned surpluses, but also such matters as the use of surpluses as a source of bank credit, the structure of taxation, virtually compulsory loans (see below), and the determination of the portion of budget revenue channeled into capital formation. In view of the central role of the budget in economic planning and the overall apportionment of resources between the socialized sector and the consumption sector, overall fiscal policy has been a more important financial regulator than monetary policy.<sup>17</sup> Budgetary policy has been used for basic decisions regarding longer-run periods (normally the duration of a five-year plan), rather than as an economic steering mechanism or for "fine tuning" when performance failures occur or miscalculations become apparent. Its chief characteristic has been a gradual restructuring of the revenue side. The precise point at which revenue for the financing of public investment, general administration, and provision of collective services is collected is largely a matter of convenience.

Since 1924, when the first steps toward overall financial planning were taken, the budget has shown a surplus, except for the war years. The interpretation of budgetary surpluses for individual years is complicated by a variety of factors, including the treatment before 1963 of the net increase in savings deposits as a regular source of revenue and the availability of bank credit to individual enterprises for discharging their liabilities toward the budget, including payment of the state's share of profits.

Budget surpluses have been an important source of increases in bank resources. Sterilized cumulative surpluses are more comparable to additions to bank capital than to banking claims.<sup>18</sup> In fact, a very large but unknown part of the liabilities of the State Bank consists of such Treasury deposits (perhaps 40 percent). Thus, by systematically building up its deposits at the State Bank the

<sup>17</sup>Powell, in Holzman [122], p. 576. He arrived at a similar conclusion for the pre-World War II years in [140].

<sup>18</sup>In contrast to China, the Soviet Union does not specifically neutralize such surpluses in a frozen Treasury account. See [123], pp. 138ff.

Ministry of Finance transfers to it command over a certain amount of real resources which, until recently, at least, the Bank has used mainly for making working-capital loans to enterprises.

Personal taxes have not played a significant part in the Soviet fiscal system since taxation of wage and salary earners was reduced to a nominal level in 1958.<sup>19</sup> In recent years, personal taxes have been applied mostly to the private income of state employees (such as income from the private practice of doctors and lawyers), to individuals producing goods or providing services outside the socialized sector, and to bachelors and small families.

The insignificance of the private sector has kept income taxation, in contrast to some other socialist countries, from becoming a potent means of syphoning off excess purchasing power. Nevertheless, due to the growth of nonwage taxation and the tax base itself, the share of revenue raised from this source rose from 5 percent in 1940 to over 8.2 percent in 1971. It must be kept in mind when interpreting this increase that, prior to 1957, compulsory loan subscriptions at the place of employment were equivalent to withheld payroll taxes. (In fact, government borrowing from the population during the twenties and thirties comprised a substantial element of overall financial policy.)

The relatively small reliance placed on personal taxes veils the basic fact that a much larger part of the social income than in the Western countries has been absorbed and disposed of by the budget. For instance, the total tax burden as a percentage of personal income, which Holzman computed to obtain an estimate of the *ex ante* inflationary gap, doubled between 1926 and 1936. According to Holzman's estimates, the average true rate of taxation oscillated between 51 and 60 percent in the 1932-1940 period, and rose further in the years immediately following World War II, reaching a peak of almost 69 percent in 1949.<sup>20</sup>

The two main sources of budgetary receipts, enterprise profits and turnover taxes, have already been discussed in Chapter 5. The overall amount of profits is determined by planning of economic performance, including the setting and attainment of profit

<sup>19</sup>See Burmistrov [19]. For the history of personal taxation, see Maryakhin [60]. See also Davies [109] and Zverev [95].

<sup>20</sup>Holzman [121], Table 53, col. I for the 1926-1936 comparison, and col. IIA for the average rate.

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<sup>21</sup>Liberman [54], p.

margins and the degree of plan fulfillment. The setting of the profit rates by industry and of turnover taxes on individual products are important means toward maintaining demand-supply equilibrium.

On balance, while the burden of taxation has remained heavy, decreasing emphasis has been placed on the turnover tax. Selective reductions in turnover tax rates for individual products and their abolition for all services in 1957 have been used to stabilize the cost of living by offsetting, when deemed desirable, production cost increases. The share of the turnover tax in total budgetary receipts declined gradually from 62.7 percent in 1940 to 31.6 percent in 1970 (see Table 8.1), but contrary to Professor Liberman's view, it is still far from "becoming more and more a dying, rudimentary form of taxation."<sup>21</sup>

The form of taxation, however, affects mainly the nominal rather than the real value of incomes. The type of tax will have only marginal effect on the distribution of the social product and the pattern of output.

Internal loans have been used from 1922 to 1956, as a means of absorbing excess purchasing power. Loan drives were conducted very much like political campaigns. Efforts to achieve subscription goals included attractive terms (including various kinds of real-value guarantees), appeals to the gambling instinct (by distributing interest in the form of lottery prizes), and to patriotism (by earmarking the proceeds of individual issues to the financing of specific major projects of national significance).

From 1927 to 1956, loans were issued annually, ostensibly to help finance voluntarily industrialization and the war effort, but, in fact, as a means of implementing a program of forced savings. Loans quotas were assigned to individual factories and other places of employment and subscriptions were collected over the year in installments by payroll deduction. Subscription was quasi-obligatory, although some allowance was made for the family responsibilities and other particular circumstances of each worker. The nonvoluntary character of subscriptions to government loans was openly recognized. The amount of such loans was gradually raised from 20 million (new) rubles for each of the three issues of 1927 to 320 million rubles for a single issue in 1956, the year in which their issuance was discontinued. The maturity of

<sup>21</sup>Liberman [54], p. 160.

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TABLE 8.1

The Share of Turnover Taxes in Total Budgetary Receipts,  
Selected Years  
(billions of rubles)

|  | 1940 | 1950 | 1960 | 1970  |
|--|------|------|------|-------|
| Total receipts <sup>a</sup>            | 16.9 | 39.2 | 76.2 | 156.2 |
| Turnover taxes                         | 10.6 | 23.6 | 31.3 | 49.4  |
| Turnover tax as percentage<br>of total | 62.7 | 60.2 | 41.1 | 31.6  |

SOURCE: Computed from [86].

<sup>a</sup> Excludes receipts from Government loans, but not from savings deposits.

such "mass loans" was initially ten years, but was lengthened to twenty in 1936. By the beginning of World War II, bonds for a total of 5 billion rubles (roughly equivalent to about the same amount of dollars) had been placed. It is estimated that about 15 percent of the costs of World War II were met by the issuance of loans. Loans were frequently over-subscribed and issued for amounts exceeding the target originally set.

At the time these forced loans were discontinued (when interest payments on outstanding indebtedness rose close to amounts of new money that could be raised in annual drives), subscriptions through payroll deductions amounted to 6 to 7 percent of total wage disbursements and 7.5 percent of total government revenue.

Holders of government bonds suffered losses in principal and income, beginning in 1930, as a result of several conversions into longer-term issues, exchange into a consolidated loan at an unfavorable rate at the time of the 1947 ruble conversion, and successive lowering of the interest rate originally set. At the time forced loans were discontinued, payment of interest on the bonds outstanding was discontinued altogether, transforming them into interest-free loans. The date of the start of retirement operations, originally set at 1977, was later advanced to 1974, and is to be completed in 1990.<sup>22</sup>

<sup>22</sup>In addition to compulsory loans, "free" lottery loans with a higher yield (3 instead of 2 percent) have been available on tap since 1947. Since 1958, it is the only security sold. The amount of such loans outstanding at the end of 1973 was 3.4 billion rubles. For a history of government borrowing, see Zverev [94] and "Gosudarstwennye Zaimy" in [27].

## INCOME POLICY

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<sup>23</sup>See Galimon [28]

INCOME POLICY

Income policy includes a number of activities: the control of wage rates and the aggregate wage bill, the entire area of state-kolkhoz relations, price setting for goods and services, and determining the range of free services to be offered.

Most, if not all, of the elements of income policy enter into the planning process itself. Thus, adjustments in wages and prices, including those achieved through varying the turnover tax, together with decisions on changes in production and foreign trade patterns, reflect basic decisions underlying the five-year plans. However, adjustments are also made in midstream. They are usually designed to compensate for deviations in actual results from plans or to achieve final goals different from original intentions (for instance, to increase the flow of goods to households at a faster pace than originally planned). Income policy may also involve, in individual years, increasing income selectively by raising hourly wages, providing incentive payments and bonuses, raising stipends and old-age pensions, and extending these to additional population groups. The most important instance of the latter was the granting of state pensions to members of collective farms in 1958.

Continuous efforts are made to keep the compensation of labor, by far the most important source of consumer purchasing power, within the limits specified in each enterprise's plan. This control of the "wages fund" is one of the most important tasks of the State Bank.<sup>23</sup> Failure to control payrolls effectively was the principal cause of pre-World War II inflation. The improved control of currency disbursements in the fifties has greatly reduced inflationary pressure and has made effective price stabilization possible. Since that time, the policy of the authorities to pass on the benefits of greater productivity through price cuts rather than by increasing nominal wages has reduced potential strains on monetary management.

During periods of increasing availability of consumer goods, real purchasing power of the population has been enlarged by

<sup>23</sup>See Galimon [28].

Equilibrium

Monetary Receipts,

| 1960 | 1970  |
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| 76.2 | 156.2 |
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lowering the turnover tax levied on specific items, by cutting prices for various categories of consumer goods thus acknowledging the reductions in production costs of consumer durables, and by reducing, at times by substantial amounts, the cost of food items distributed through government and "cooperative" channels. Subsidies have also been quite widely used and manipulated when price changes to reflect higher costs appeared undesirable or when it seemed desirable to sell some food and other items below cost.

As a means of absorbing excess purchasing power in the household sector, the Soviet Union has resorted several times to general upward price adjustments. Price increases for consumer goods reduce the real value of cash balances in the hands of the population while increasing budgetary resources.

Since prices have no direct effects on production, the level of average factory prices at which output is sold to organizations in charge of distribution and exports can be set to facilitate administration of the economy. Average-cost pricing and average profit-margin targets are used for this purpose. Some prices are set to achieve noneconomic goals such as combating alcoholism or encouraging reading of official publications.

### *From Inflation to Price Stability*

Since the initiation of central planning, the degree of inflationary pressures acting on the Soviet economy has depended to a large extent on the skill with which credit, fiscal, price, production, and inventory policies have been combined and applied to specific situations, and on how close the prognosis of future developments has been to actual performance. It is less than obvious what contribution monetary and credit policy have made to limiting inflationary pressures during the pre-World War II period. For the period following the war, an almost complete lack of relevant data precludes any attempt to quantify their influence.

Since the required monetary statistics, such as currency in circulation, are not available, the underlying developments must be inferred from fragmentary and indirect evidence. On the ques-

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tion of what indirect measures best reflect inflationary pressures, opinions among students of the Soviet economy differ. Some have used official price indexes<sup>24</sup> or those constructed by Western experts, while others have relied on evidence of changes in inventories or savings deposits. Another indirect measure of inflationary pressures is the relationship between budget surpluses and the expansion of short-term credit. The use of this indicator is, admittedly, beset by a number of difficulties; for instance, some of the resources available for lending are derived from current budgetary appropriations "for the reinforcement of the resources of the State Bank" rather than from past or current surpluses. Furthermore, it is not known what part of the increase in bank credit has resulted in a net increase in currency in circulation. While some broad assumptions and adjustments can be made, they do not yield a sufficiently complete and reliable picture, either for individual years or for selected periods.

#### PRICE DIFFERENCES IN PARALLEL MARKETS

Still another measure of inflationary pressure may be obtained by comparing price movements in the parallel markets which have operated in the Soviet Union. Prior to 1935, when a uniform price system was established for goods sold by state stores, several separate markets were operating in addition to the *kolkhoz* market, which has remained by far the most important free market.

Price levels and movements in these markets differed because of compartmentalization of supply and differentiated demand schedules, and because of shifts in these schedules in response to a variety of factors, including relevant price changes in competing but different markets.

During the pre-1935 period at least three categories of prices

<sup>24</sup>For a comprehensive review and critique of Soviet price data, see Jasny's pathbreaking study [124], and Bornstein, "Soviet Price Statistics," in [161], which has an extensive bibliography. See also Chapman [108], Chapters 2 to 6. A considerable amount of Soviet price data is summarized in tables and charts in Malafeev [57]. This monograph contains a detailed discussion of price history and a surprisingly candid discussion of inflationary pressures. It also includes a chronology of party and government decisions regarding prices between 1917 and 1963.

were relevant for households: (1) ration prices for goods to the urban population holding ration cards; (2) commercial prices for goods purchased predominantly by urban households (higher than ration prices); and (3) free *kolkhoz* market prices at which households could buy food. Prices in two special markets completed the price structure: (4) prices in "cooperative" country stores (the state network of retail stores in the villages), at which farmers could buy manufactured goods; and (5) prices (in gold rubles) in special stores for foreigners and the few Soviet citizens able to pay in foreign exchange.

The unification of prices and the abolition of rationing at the end of 1947 left only two price systems—official prices in state stores, now incorporating the network of cooperative stores, and the *kolkhoz* market.<sup>25</sup>

The failure to drain off excess purchasing power or to increase the availability of consumer goods and services can be traced by comparing price movements between these markets. The *kolkhoz* market is the only market in which prices are set by producers. It consists of thousands of stores and stands through which *kolkhozes* and, especially their individual members, sell that part of their output for which they have freedom of disposition. This market has been the most important—and visible—indicator of the intensity of inflationary pressures. When the urban population cannot satisfy its demand at the state retail stores and seeks to obtain additional food in the *kolkhoz* market, a redistribution of purchasing power takes place, and a restructuring of the demand for final products results. However, since the propensity of the *kolkhoz* farmers to save is apparently higher than that of the urban population, some reduction of repressed inflation takes place. On the theory that, for all practical purposes, the *kolkhoz* market has been the only, or at least by far the most important, outlet for such excess demand, the ratio of prices in that market to those in state stores has been used as a rough indicator of inflationary pressures (see Table 8.2).<sup>26</sup>

<sup>25</sup>Jasny [124].

<sup>26</sup>While special stores for sales against convertible foreign exchange have continued in existence in a modified form, they do not play the same role as before World War II and are, in fact, much more limited to serving tourist and some privileged groups of Soviet citizens.

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## PERIODS IN SOVIET MONETARY EXPERIENCE

The monetary experience of the Soviet Union can be divided into five periods:

1. The years of war communism and of the New Economic Policy prior to the currency reform of 1924.
2. The period between 1924 and the introduction of the credit reforms of 1930–1932.
3. The period from 1933 up to the Soviet Union's entry into World War II.
4. World War II and on to the currency conversion at the end of 1947.
5. From 1948 to the present, which subdivides into a period of deflation through 1954 and one of considerable price stability thereafter.

The first two periods have been analyzed by several writers and have already been dealt with briefly in Chapter 2.<sup>27</sup> Since our focus is on the monetary system that emerged after the 1930–1932 reforms, only the periods following them will be reviewed here. The available price data for the entire period 1928–1970 are summarized in Table 8.2.

*1932–1940.* The credit reforms of 1930–1932 created a financial system which would have made it possible to achieve an equilibrium between material and monetary flows. However, the actual

<sup>27</sup>See Arnold [100], Katzenellenbaum [126], Reddaway [142], and Yurovski [92]. Holzman has developed an indicator of repressed inflation based on an estimate of the effect of the spillover of the urban population's purchasing power into the *kolkhoz* market for food products. This index, which Holzman qualifies as partial, is the ratio of the difference between actual expenditures in the *kolkhoz* market and the same expenditures valued at official retail prices at state stores to the sum of total purchases from these two sources valued at state store prices. Such a comparison of fixed and free prices for food is, of course, only a rough indicator of the strength of inflationary pressures (see Table 8.4). The formula is given in [240], p. 170. Short-term fluctuations, and in some cases longer-run comparisons as well, are influenced by the changes in each market's share of total food sold and in fixed prices in the state stores. They are also affected by the construction of the price indexes being compared and by the limitation of the available estimates of the quantities sold and prices charged in the thousands of separate outlets operated by individual *kolkhozes*, in some cases at a considerable distance from the point of production. Also, some purchases from *kolkhozes* and of the private output of their members bypass officially recognized markets from which price data are collected. A more sophisticated version of this measure takes into account the share of food purchased in the free market as well as prices reported in this market.

TABLE 8.2  
Indexes of Retail and Related Prices

|      | Retail Prices in State<br>and Cooperative Stores<br>(1937 = 100) |            | Cost of Living <sup>e</sup>                    |   |                                 |  |   |
|------|--|------------|--|---|---------------------------------|--|---|
|      | Malafeev <sup>a</sup>  | Moorstein- | Kolkhoz<br>Market <sup>c</sup><br>(1937 = 100) | Retail<br>Prices <sup>d</sup><br>(1940 = 100) | 1937<br>Weights<br>(1937 = 100) | Current<br>Year<br>Weights<br>(1937 = 100) | Consumer<br>Prices <sup>f</sup><br>(1950 = 100) |
| 1928 | 18.7   |            |  |   | 20.9                            | 14.3                                       |   |
| 1931 |  | 19.7       |  |   |                                 |  |   |
| 1932 | 47.6   | 36.4       | 430  |   |                                 |  |   |
| 1933 |  | 54.5       | 250  |   |                                 |  |   |
| 1934 |  | 64.3       | 200  |   |                                 |  |   |
| 1935 |  | 83.2       | 170  |   |                                 |  |   |
| 1936 |  | 94.2       | 100  |   |                                 |  |   |
| 1937 | 100.0  | 100.0      | 100  |   | 100                             | 100  |   |
| 1938 |  | 100.0      |  |   |                                 |  |   |
| 1939 |  | 102        |  | 100   |                                 |  |   |
| 1940 | 118.8  | 126        |  | 100   | 142                             | 136  |   |
| 1944 |  | 149        |  |   |                                 |  |   |
| 1945 | 259.1  | 168        |  |   |                                 |  |   |
| 1946 |  | 237        |  |   |                                 |  |   |
| 1947 | 381.5  | 346        |  |   | 327                             | 294  |   |
| 1948 |  | 300        |  |   |                                 |  |   |
| 1949 |  | 268        |  |   |                                 |  |   |
| 1950 | 221.3  | 222        |  | 186   |                                 |  | 100.0   |
| 1951 | 202.1  | 206        |  |   |                                 |  |   |
| 1952 | 191.4  | 198        |  | 161   | 220                             | 202  |   |
| 1953 | 173.5  | 180        |  |   | 188                             | 178  |   |
| 1954 | 163.2  | 170        |  |   |                                 |  |   |
| 1955 | 163.2  | 170        |  |   |                                 |  |   |
| 1956 | 163.4  | 171        |  |   |                                 |  |   |
| 1957 | 163.2  | 171        |  |   |                                 |  |   |
| 1958 | 166.8  | 175        |  |   |                                 |  | 76.6  |

|      |       |     |     |     |       |
|------|-------|-----|-----|-----|-------|
| 1945 | 259.1 | 168 |     |     |       |
| 1946 |       | 237 |     |     |       |
| 1947 | 381.5 | 346 |     |     |       |
| 1948 |       | 300 | 327 | 294 |       |
| 1949 |       | 268 |     |     |       |
| 1950 | 221.3 | 222 | 186 |     | 100.0 |
| 1951 | 202.1 | 206 |     |     |       |
| 1952 | 191.4 | 198 | 161 | 220 | 202   |
| 1953 | 173.5 | 180 |     |     |       |
| 1954 | 163.2 | 170 | 188 | 178 | 76.6  |
| 1955 | 163.2 | 170 |     |     |       |
| 1956 | 163.4 | 171 |     |     |       |
| 1957 | 163.2 | 171 |     |     |       |
| 1958 | 166.8 | 175 |     |     |       |
| 1959 | 166.2 | 174 |     |     |       |
| 1960 | 164.0 | 173 | 139 |     | 76.3  |
| 1961 | 163.1 |     |     |     | 76.4  |
| 1962 |       |     |     |     | 77.9  |
| 1963 |       |     | 141 |     | 78.8  |
| 1964 |       |     |     |     | 79.1  |
| 1965 |       |     | 140 |     | 77.8  |
| 1966 |       |     | 121 |     | 76.9  |
| 1967 |       |     | 121 |     | 76.9  |
| 1968 |       |     | 120 |     | 77.0  |
| 1969 |       |     | 128 | 139 | 77.7  |
| 1970 |       |     |     | 139 | 77.9  |
| 1971 |       |     |     |     | 77.7  |
| 1972 |       |     |     |     | 78.5  |

<sup>a</sup> Malafeev [57].  
<sup>b</sup> Moorstein-Powell, [134], Table P-3, pp. 635-636; for 1937, 1940, 1948-1955 from Bergson [103], interpolated (straight line and free-hand interpolations) for other years as explained on pp. 574-576 and 637. For 1956-1960, official index, changed in 1955.  
<sup>c</sup> Holzman [240].  
<sup>d</sup> Official index from [86], 1969, p. 625. Not available on this or any other base prior to 1940.  
<sup>e</sup> Chapman [108], Table 6. See Ch. VI for detailed description.  
<sup>f</sup> David W. Bronson, private communication.

policies pursued through the successive five-year plans of accelerated industrialization did not bring about price stability. The credit reform hardly slowed the rise in consumer prices, and the flow of purchasing power to consumers continued to exceed the available supply of consumer goods at official prices by considerable amounts, so that a state of repressed inflation developed. Consumer prices rose sharply between 1933 and 1936 (from 54.5 to 94.2, according to the Moorestein-Powell Index), and more slowly (by about 10 percent for the entire three-year period) between 1936 and 1939. As Table 8.1 shows, they rose sharply again between 1939 and 1940.

The inflation was the joint consequence of a systematic under-allocation of resources to consumer goods production and of a wage drift which was an almost unavoidable by-product of the industrialization policy pursued. The supply situation in this period was worsened still further by a reduction of food supplies resulting from the forced collectivization and related farm policies. The vigor of the inflationary pressures is evident (or can be derived) from official statistics, despite their shortcomings, gaps, and inconsistencies.<sup>28</sup>

Control over payrolls was introduced soon after the credit reform early in 1933, in the form of monthly and quarterly "standard certificates for wages," issued to individual enterprises. To allow for the increase in average skills and to attract workers into the rapidly growing industrial area authorities *planned* average wage increases of up to 9 percent in some years. *Actual* annual increases, however, were considerably larger, ranging up to 25 percent or more a year. Thus, the "wage drift" alone was typically in excess of the projected overall rate of increase.<sup>29</sup>

Moreover, according to Pickersgill's estimates, the income velocity of currency circulation rose from 5.9 in 1933 to 14.9 in 1937.<sup>30</sup> At the same time, neutralization through budget surpluses

<sup>28</sup>Atlas [163], p. 88. claims, apparently on the basis of unpublished data, that in the five years immediately preceding World War II (1935-1940) currency circulation was permitted to increase only in proportion to the availability of consumer goods through trade channels. He gives a coefficient of correlation of .96 for this period between these two magnitudes.

<sup>29</sup>See Holzman [121], p. 39, 309-310; and [240], p. 177.

<sup>30</sup>[138], Table III, p. 55.

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<sup>31</sup>[121], pp. 53 and

<sup>32</sup>[140], pp. 267, 2

<sup>33</sup>[140], p. 337.

of monetary expansion resulting from issuance of short-term credit was quite moderate.<sup>31</sup>

Powell found that for 1935–1937 available evidence scarcely suggests any systematic coordination of credit and budgetary policy, while for the thirties as a whole, the money stock and budgetary surpluses were *negatively* correlated. If the authorities did, in fact, pursue a policy of using surpluses to offset undesirable movements in the money stock, its effects must have involved lags of an undetermined nature.<sup>32</sup> Powell concluded that while excess monetary demand in the period between the credit reform and World War II possibly served to assure a maximization of output, “monetary policy has more frustrated than facilitated the attainment of those ultimate objectives which the system was meant to serve,”<sup>33</sup> namely, price stability, orderly distribution of the social product, and growth. It may be added that the burden of a widening and tightening of financial controls must be counted among the “real consequences” of the failure of the monetary and banking system prior to World War II to effectively deal with excess monetary demand.

The pre-World War II inflation cannot be considered a planned policy of financing forced industrialization through inflation. Indeed, the successive plans projected a decline in the price level designed to pass on to consumers a large part of the benefits of rising productivity. The first plan (1928–1932) also provided for a growth of currency circulation (62 percent) slower than that of the increased availability of consumer goods (80–90 percent); no doubt, however, a considerable monetary overhang existed at the start of this period.

Clearly, before World War II there were enough leakages in the control system and enough weaknesses and uncertainties in the underlying plans to result in an almost continuous rise in the price level (though some diminution of inflationary pressures is reflected in the sharp drop of Holzman’s indicator from 17.3 in 1933 to 7.7 in 1940). Actual spending could rise above the

<sup>31</sup>[121], pp. 53 and 229.

<sup>32</sup>[140], pp. 267, 296–298.

<sup>33</sup>[140], p. 337.

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amounts planned *ex ante* primarily because enterprises exceeded the planned amounts of payrolls, and, to a limited extent, because consumers activated currency hoards. As a result, a significant disequilibrium between monetary demand and the available supply at fixed prices characterized the years between the credit reform and the Soviet Union's entry into World War II in 1941.

1941-1947. The financing of the Soviet war effort involved neither large-scale issuance of currency nor borrowing from the State Bank.<sup>34</sup> Prices rose rapidly, particularly during the first three war years (1941-1943). In July 1943, prices for the main categories of farm products in the *kolkhoz* market were 18.7 times their July 1941 level (having reached a peak in April 1943); the *kolkhoz* market's share of food sales rose between 1940 and 1945 from 20 to 51 percent, and of all retail sales, from 14 to 46 percent. According to Malafeev's calculations, the weighted index of prices of goods sold in the state and *kolkhoz* market in 1945 was still 325 percent of the 1940 level, while the index of prices in state and cooperative stores alone was nearly 2.2 times higher.<sup>35</sup>

During World War II, the State Bank continued its usual activities, which were disrupted in large areas of the national territory for several years by military operations and by the German occupation. As in other countries engaged in war, it serviced the currency needs of the army. Its normal credit activities were complicated not only by the temporary loss of territory to the occupying armies of Germany and its allies, but also by the large-scale evacuation of factories to Siberia, Central Asia, and other areas removed from the theatre of operations. It is remarkable that neither the use of Soviet currency by the invading armies (along with occupation currency issued by them), nor the dislocation of normal economic activity and administrative structure in occupied areas, nor the subsequent incorporation into the Soviet Union of large territories on its Western border resulted in monetary chaos.

The war-generated overhang of liquidity consisted essentially of currency in the hands of consumers, especially the farmers,

<sup>34</sup>Deficits in the earlier war years amounting to a total of 32 billion rubles were followed by small surpluses in the last two years (1944 and 1945).

<sup>35</sup>[63], pp. 234, 235, and 407.

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who had been unable to spend their income during the war years because of the shortage of goods. It was removed by the currency conversion of 1947 (see Chapter 3).

1948-1972. Following the currency conversion of 1947, which abolished wartime rationing, the trend in prices was almost continuously downward until 1954; since then, average consumer prices have remained about level. The share of the *kolkhoz* market in total retail sales (valued in prices actually paid in both markets) declined from 12.0 percent in 1950 to 4.5 percent in 1960 and 2.8 percent in 1969.<sup>36</sup> In the postwar period, the State Bank has been clearly more effective than before in controlling disbursements from enterprise balances, and spending for unauthorized purposes, particularly for wages, has been significantly reduced. For instance, any overspending on payrolls is required to be offset by compensating reductions in aggregate wage payments by the offending enterprise in the following three to five months.

The degree to which fiscal policy has contributed to maintaining a relatively high degree of price stability is not clear. Yet the contrast between the period before World War II and that following the currency conversion of 1947 is striking. In the eleven years beginning January 1, 1930, the cumulative budget surplus of 26.4 billion rubles (most of which was sterilized in the treasury account of the State Bank) was little more than half as great as the 50.6 billion ruble increase in short-term loans outstanding. By contrast, in the years 1951 through 1956, budget surpluses exceeded increments in bank loans.<sup>37</sup> However, as Holzman points out, judging from price changes in individual years, over short-run periods the budget surplus-loan expansion offset mechanism was no more effective in the fifties than it had been in the thirties.

Fluctuations of consumer goods prices in state stores, in the *kolkhoz* market, and in the ratio of the two price indexes since the end of World War II must be viewed from the perspective of a huge increase in money income during this period. With the sum of taxes and other deductions (mainly state loan subscriptions)

<sup>36</sup>[92], 1969, p. 600. Valued in state store prices, the decline was from 11.4 to 3.0 and to 1.8 percent, respectively.

<sup>37</sup>Powell in Holzman [122], p. 4. It must be kept in mind that in Soviet budgets the sale of government bonds is considered a regular source of receipts.

rising at a more moderate rate than monetary income, total disposable income in 1970 was more than three times as large as in 1950, according to official data. In spite of a rapid rise in population, real 1970 per capita income deflated by official retail prices was more than four times as large as twenty years earlier (Table 8.3, last line), since these prices on balance show a decline over the period. During the same time, the proportion of food purchased in the *kolkhoz* market, which is not reflected in the official price index, declined, particularly after 1958, while the percentage of income saved increased sharply.

The main components of monetary income and their disposal are summarized in Table 8.3. Gross earnings of wage and salary workers constitute the bulk of money income. Wage payments to the members of *kolkhozes* and various types of transfer payments (mainly pensions), accounting for more than one-fifth of the total in 1970 (against 12 percent in 1950), rose even more rapidly. Net income from the sale of farm products by the *kolkhozes* and their individual members in 1970 was slightly more than double the 1950 level and a much larger part of income generated in the *kolkhoz* sector was distributed in money wages. "Other income," of which military pay is the largest component, declined gradually in the two decades.

A detailed examination of the Soviet price indexes cannot be undertaken here. Most Western scholars have considerable reservations on many accounts, but are inclined to accept them as rough approximations reflecting the basic changes over time. According to the official retail price index<sup>38</sup> (Table 8.2, column 4), the consumer prices remained virtually unchanged during the sixties, following a sharp decline during the fifties.

The fact that since the end of World War II prices in the *kolkhoz* market have continued to exceed food prices at state stores suggests that available supplies, choice, and quality of food carried by state stores continue to be deficient. The ratio of the two price indexes rose sharply between the fourth quarter of 1950 and 1955 (see Table 8.4), and Holzman's indicator of suppressed

<sup>38</sup>The size of the bias in the available official price indexes is unknown. Thus, during 1969-1970, ceilings were placed on the supposedly free collective farm market prices. At the same time, there has been increased evidence in recent years of surreptitious price increases for various consumer goods. See Bush, "Soviet Inflation," in Lulan [127].

TABLE 8.3  
Disposable Money Income, Selected Years, 1950-1970  
(in billions of rubles)

|   | 1950 | 1955 | 1960 | 1965 | 1970  | 1972  |
|---|------|------|------|------|-------|-------|
| Gross earnings of wage and salary workers | 31.1 | 43.3 | 60.0 | 89.1 | 132.0 | 148.9 |
|   | 1.1  | 3.1  | 5.1  | 9.1  | 13.5  | 14.7  |

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From Inflation to Price Stability

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TABLE 8.3  
Disposable Money Income, Selected Years, 1950-1970  
(in billions of rubles)

|   | 1950  | 1955  | 1960  | 1965  | 1970  | 1972  |
|---|-------|-------|-------|-------|-------|-------|
| Gross earnings of wage and salary workers               | 31.1  | 43.3  | 60.0  | 89.1  | 132.0 | 148.9 |
| Collective farm wage payments                           | 1.1   | 3.1   | 5.1   | 9.1   | 13.5  | 14.7  |
| Net income from the sale of farm products               | 4.5   | 4.5   | 6.0   | 7.2   | 9.6   | 15.8  |
| Other <sup>a</sup>                                      | 5.4   | 5.8   | 3.9   | 3.4   | 3.5   |       |
| Transfer payments                                       | 4.8   | 6.9   | 11.3  | 15.7  | 24.4  | 27.1  |
| Total money income                                      | 47.0  | 63.5  | 86.2  | 124.4 | 183.0 | 206.5 |
| Direct taxes  | 3.6   | 4.8   | 5.6   | 7.7   | 12.7  | 15.1  |
| Other deductions <sup>b</sup>                           | 2.9   | 3.3   | 0.4   | 0.4   | 0.7   |       |
| Total disposable income                                 | 40.5  | 55.4  | 80.2  | 116.3 | 169.5 | 191.8 |
| Per capita disposable income (rubles)                   | 224.8 | 282.4 | 274.4 | 503.7 | 698.2 |       |
| Index of real per capita disposable income <sup>c</sup> | 100.0 | 164.0 | 218.3 | 288.0 | 400.8 |       |

SOURCE: Bronson and Severin in [152 and 153]; for 1972 preliminary estimates (communication from M. Bronson).

NOTE: Totals may not add up due to rounding.

<sup>a</sup> Mostly military pay.

<sup>b</sup> 1950 and 1965 include 2.7 and 3.1 billion rubles of government loan subscriptions, respectively.

<sup>c</sup> Deflated by the official consumer price index (1950 = 100).

TABLE 8.4  
Indicators of Inflationary Pressures, Selected  
Years, 1940-1971

| I. Ratio of Collective Farm Market to State Retail Prices for Food |                   |                     |      |      |     |
|--|-------------------|---------------------|------|------|-----|
| 1940 Annual average  | 1.78              | 1955 Four quarters  | 1.74 |      |     |
| 1945 Annual average  | 5.33              | 1955 Annual average | 1.75 |      |     |
| 1947 Four quarters   | 2.98              | 1960 Annual average | 1.35 |      |     |
| 1950 Four quarters   | 1.25              | 1964 Annual average | 1.63 |      |     |
| II. Holzman's Indicator <sup>a</sup>                               |                   |                     |      |      |     |
| 1932   | 17.1 <sup>b</sup> | 1950                | 2.5  | 1954 | 4.2 |
| 1933   | 17.3              | 1951                | 3.4  | 1955 | 4.1 |
| 1940   | 7.7               | 1952                | 4.8  | 1956 | 2.8 |
|  |                   | 1953                | 3.5  |      |     |
| III. Partial Indicator of Suppressed Inflation<br>(1955 = 100)     |                   |                     |      |      |     |
| 1950   | 39                | 1960                | 30   | 1966 | 24  |
| 1955   | 100               | 1961                | 38   | 1967 | 24  |
| 1956   | 59                | 1962                | 37   | 1968 | 22  |
| 1957   | 40                | 1963                | 36   | 1969 | 25  |
| 1958   | 41                | 1964                | 39   | 1970 | 22  |
| 1959   | 32                | 1965                | 28   | 1971 | 23  |

SOURCES: For I, 1940-1955, see Holzman [240], pp. 168-170; for 1955-1964, see Bronson and Severin in [153], p. 514, revised and updated by the authors. For II, including formula for the indicator, see Holzman [240], pp. 168-170. For III, see Bronson and Severin, as above.

<sup>a</sup> 1950-1956: fourth quarter only.

<sup>b</sup> Probably understated; see [133], p. 258.

inflation rose from 2.5 to 4.1. Bronson and Severin,<sup>39</sup> who have recomputed Holzman's indicator of suppressed inflation on the basis of more recent data and carried it forward to 1971, found an even greater rise between 1950 and 1955 (based on annual averages). The decline in the overall price level prior to 1955 is explainable largely by a reduction in state store prices, while the subsequent decline through 1960 was due to a decline in the share of the higher-priced *kolkhoz* market in total food sales. The index of repressed inflation rose again moderately and irregularly between 1960 and 1964, reflecting rising *kolkhoz* market prices, with disposable money income up by nearly 30 percent at the end

<sup>39</sup>David W. Bronson and B. Severin, "Recent Trends in Consumption and Disposable Income in the USSR," in [153], p. 500. I am indebted to D. Bronson for supplying the revised and extended data, shown in Table 11.

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<sup>40</sup>Unpublished es  
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in Grossman [118].

Prices, Selected

|                        |      |
|------------------------|------|
| Retail Prices for Food |      |
| four quarters          | 1.74 |
| annual average         | 1.75 |
| annual average         | 1.35 |
| annual average         | 1.63 |

|      |     |
|------|-----|
| 1954 | 4.2 |
| 1955 | 4.1 |
| 1956 | 2.8 |

Inflation

|      |    |
|------|----|
| 1966 | 24 |
| 1967 | 24 |
| 1968 | 22 |
| 1969 | 25 |
| 1970 | 22 |
| 1971 | 23 |

[40], pp. 168-170; for 1974, revised and updated indicator, see Holzman and Verin, as above.

Verin,<sup>39</sup> who have studied inflation on the Soviet Union in 1971, found an annual average inflation rate prior to 1955 is 1.7 percent, while the annual average rate in the share of total sales. The index of market prices, and irregularly fluctuated 10 percent at the end

of income and Disposable Income for supplying the

of the four-year period,<sup>40</sup> but it declined through 1966 and fluctuated little thereafter.

The much improved post-World War II price experience, during the sixties in particular, was due, at least in part, to a more skillful coordination of fiscal and bank policy which made it possible to achieve a declining and eventually stable price level. Since a considerable part of the typical worker's budget during the war had been spent on food purchased at free market prices, an initial upward adjustment of food prices at state stores was required in the first postwar years to reduce the spread between official and free market ("commercial") prices in order to make abolition of food rationing feasible. This, however, did not bring a complete unification of the price system. The real income of wage and salary earners was fairly rapidly reestablished by subsequent price reductions, mainly for manufactured products.

Factors Contributing to Price Stability

The Soviet Union has managed to avoid the inflationary crises that have created considerable difficulties in many of the other socialist countries<sup>41</sup> and, in the sixties, was able to widen options available to consumers. While it is difficult to assess the relative contributions of the main financial tools in achieving the impressive degree of price stability prevailing in the sixties, the following have clearly been the most important contributing factors. 1. Closer adherence to financial plans (improved "financial discipline") by enterprises. 2. A more successful balancing of currency flows going to the population vis-à-vis the increased availability of consumer goods. Since the discontinuance after 1957 of the forced placement of government bonds, the authorities' ability to attract a large volume of voluntary deposits into savings banks also helped to keep the growth of effective demand within desirable limits. 3. Greater efficiency and promptness in absorbing excessive amounts of currency paid out, mainly by manipulation

<sup>40</sup>Unpublished estimates by D. Bronson.

<sup>41</sup>See, for instance, Podolski [139] and the articles on Poland by Brzeski and by Montias in Grossman [118]. On China, see Hsiao [123].

of administered prices and of turnover taxes. 4. The more efficient control of wages, and more importantly, greater success of the State Bank in controlling actual withdrawals of currency for payrolls.

Many unanswered questions remain, however. Did the system offer much more scope for monetary and credit policy beyond the role it actually played? No doubt from the thirties to the mid-sixties the system by and large fitted the requirements of the centrally directed economy. But was there room, without undermining its principal characteristics, for developing a market sector or para-market mechanisms through which production and distribution of certain consumer goods and services would be guided by monetary demand and prices would reflect the play of supply and demand? Could a wider application of monetary tools and processes have achieved more efficient resource use within the framework of planners' intentions? Could the operational aspects of the monobank have been improved significantly without undermining the basic premises of a banking system whose main function was to make real flows meet plan objectives, not to influence them? Could credit financing of investment, even along the modest lines of the 1965 Reform, have contributed to reducing completion delays and thus diminish the volume of real resources not contributing to current output? These questions with regard to the past have assumed added significance since the launching of the Reform.

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