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Money in a Centrally Directed Economy

THE role that money, credit, and financial flows play in the Soviet Union differs significantly from that in nonsocialist countries. For one thing, official Soviet economic theory has had considerable trouble over the years in defending the very existence of money under socialism and in legitimizing the use of credit and interest charges. For another, ever since the inauguration of the planned economy, Soviet economic policy has been implemented by a combination of planning, direct allocation of resources, and administrative controls that does not include any independent role for money and monetary policy.

Soviet money performs its function in an economy characterized by differentiated markets and by a price system in which price changes depend on administrative decisions rather than on supply and demand factors. To achieve equilibrium conditions and growth objectives, primary emphasis is placed on the administrative allocation of existing, as well as on the development of additional, real resources; monetary management does not go beyond assisting in the implementation of plans cast in physical terms. Credit, too, is issued mainly for carrying required inventories and to facilitate payments. For a fuller discussion of Soviet policy regarding credit and monetary equilibrium, see chapters 6 and 8, respectively.

Soviet Monetary Theory

The economic literature of the Soviet Union has been characterized by a good deal of confusion about the nature of money, the role of the monetary process, and the function of the banking system. Undoubtedly, rigid official adherence to the theories of Marx have hampered monetary analysis. Accepting such concepts as interest charges and recognizing the monetary nature of bank deposits have presented problems for the theoretician and policy maker. In fact, a coherent theory underlying the management of money by the socialist state has yet to be formulated.[1]

Soviet monetary theory has long been inhibited by its refusal to recognize that Karl Marx's pronouncements on gold, circulation of commodities, credit, and financial flows were derived from the analysis of a specific, early stage in the development of the capitalist economy and do not necessarily have the same validity in a socialist economy.[2] Still following Marx, who identified money with gold and was blind to credit creation as a source of deposit money and its equivalence to money of other origin, Soviet theory considers fiduciary money and bank deposits to be merely substitutes for gold. A typical treatise still proclaims that "credit (paper) money in actual circulation in socialist countries merely represents gold. The quantity of money in circulation is, as a rule, limited by the demand of the national economy for real money—gold."[3]

While a review of the early history of Soviet monetary theory is largely irrelevant here, it is worth mentioning that the notion of

[1]For a brief review of the rate of economics as a science in the Soviet Union, see Nove [137], Ch. 11.

[2]On this, see the section "Marxian Monetary Theory and Soviet Practice" in Spulber [145], pp. 155–158. See also the interesting discussion by the late Hungarian economist Varga [252].

[3]Aizenberg [1], p. 85. For a recent discussion of the role of gold in communist countries and foreign exchange problems, see also Z. Atlas [162], Altman [214], and Wyczalkowski [255]. In this connection, it is well to remember that under the Tsarist regime, paper currency was called "credit notes" rather than money.

separate payments circuits discussed in Chapter 6 is clearly traceable to the views of Preobrazhenski, perhaps the most influential figure in the early period of Soviet economics. In 1918, he advocated the disappearance of money from the state sector of the economy, but after a brief interlude of War Communism the indispensable role of money in the first state of "building socialism" was recognized, and by 1930, the theoretical basis of the standard system, with its emphasis on the payments and control functions of money, was firmly established.[4]

Soviet monetary theory does not deal with conditions of monetary equilibrium or with models designed to estimate proper growth rates of monetary aggregates. Official descriptions of the role of money and credit have tended to emphasize technicalities rather than substance. Soviet monetary literature deals almost exclusively with the practical problems of controlling currency circulation. Soviet monetary economists denied the monetary nature of deposits at the State Bank, most of them viewing such balances merely as a clearing fund, a liability of the Bank, or a potential claim to currency.

That Soviet banks create credit in the same way as banks in capitalist countries was recognized by L. Shanin as early as 1925,[5] but until the late 1940s Marxist orthodoxy prevailed. The view that bank liabilities may be created also through lending became respectable, if not generally accepted, only toward the middle 1950s. But it was not until the middle 1960s that the theory of the credit origin of money became widely held.[6] After decades of doctrinaire and often hair-splitting discussion, much of which revolved around interpreting Marx's comments on money in the context of a socialist economy, the view that deposits (or, in Soviet terminology, balances of enterprises and of the Treasury at the State Bank) *do* constitute money seems to have prevailed, even though the debate is still continuing.

[4]For monetary views of early Soviet economists, see Roussel [248].

[5]His views appeared that year in a series of articles in the April, June, and July issues of *Ekonomicheskoye Obozrenie*.

[6]This theory was advanced by Steinshleger, Pessel', Kronrod, Levchuk, Sitnin, Shwarz, Melkov (see Bibliography) and accepted by the veteran monetary economist Z. Atlas, who is responsible for the section on "The Credit Character of the Creation of Money" in Gerashchenko's textbook [29].

The Monetary Unit

The Soviet monetary system is a classical case of managed fiat money, the volume of which is regulated directly and effectively by state authority through a wide range of controls, including a foreign exchange monopoly.[7] Official claims that all domestic money is "fully backed by material values" or that the ruble is "adequately secured by gold and other precious metals and stones"[8] merely prove the survival of outdated monetary theories of pre-Soviet vintage. The 25 percent cover of gold and other precious metals and stones which bank notes are supposed to have, however, is now given little emphasis by Soviet authorities, while it is stressed that the backing of currency issued by both the State Bank and the Treasury consists in "goods owned by the state and salable at fixed prices."

The monetary unit created in 1922 (see Chapter 2, p. 27) remained unchanged until 1947, when a currency conversion similar to those undertaken by several Western European countries was effected after the war. It was designed to deal with an inflationary situation aggravated by a liquidity overhang created by wartime developments, including war financing. In addition to the general problem of excess consumer purchasing power held in the form of currency hoards, a special distributive problem existed in the Soviet Union: a large part of the excess currency was concentrated in the hands of the peasants as a result of sales of foodstuffs at "free" prices (usually considerably above those fixed for similar items sold in state or cooperative stores on the basis of ration cards issued after 1941 to the urban population). The conversion aimed at a reduction of this overhang of purchasing power with-

[7]One of the earliest, clearest, most succinct, and, at the same time, sophisticated statements on the credit origin of money, the nature of cash balances, and the role of money in the Soviet economy may be found in Sitnin's booklet [78]. See also Melkov [61], Ch. 2, for a review of the positions taken by various Soviet economists on the relationship of the money supply to bank credit. Konnik [47], Ch. 4 and Levchuk [53].

In 1971, it was still necessary for an economist of the State Bank to justify the use of the term "loanable funds" and to raise, for the first time since the creation of the monobank system, the question of bank liquidity and its determinants: Levchuk [58], pp. 211–213.

[8]Paper currency was originally issued by the Ministry of Finance (since 1924) as well as by the State Bank. The former issued the smaller denominations (up to 5 rubles prior to the currency exchange of 1961) and the latter, bank notes of larger denominations. Currently, the Ministry of Finance issues only coins. Trubenkev [87], p. 13.

out which the abolition of rationing of consumer goods, promulgated simultaneously, would not have been possible.

In the 1947 conversion currency in circulation was reduced to an amount just adequate to meet payroll requirements for one income period. It was assumed that (a) almost the full amount of wages and salaries disbursed would be spent in trade and service establishments and returned to the State Bank at the end of the period, and that (b) much of the remainder would be recaptured through savings banks, both of which would be available for meeting the next week's wage bill. Analysis of the relevant monetary and expenditure aggregates suggested that the amount of currency actually in circulation[9] was ten times larger than this amount, and a conversion rate of 1:10 was chosen. The conversion was not announced in advance. It was undertaken at the end of a pay period (December 14), when currency holdings in the hands of the population could be expected to be at a minimum.

Given the purpose of the currency conversion, no simultaneous change in wage rates or prices were required. Wage rates remained unchanged and enterprise bank balances were not subject to reduction, since they could be adjusted as needed by administrative action. Balances held by producers' cooperatives and *kolkhozes* were converted at the same one-to-ten ratio that applied to currency held by the general population.

The value of the financial assets held by the population—government bonds and savings deposits—was reduced simultaneously with currency conversion, but at rates more favorable than the currency exchange rate in order to discourage currency hoarding in the future. A relative advantage was given to small savings deposits.

The currency exchange effective January 1, 1961,[10] in which ten old rubles were exchanged for one new ruble, may be compared with the shift to a "heavy" currency (such as the "heavy franc") undertaken by several Western countries. In these countries the exchange for a new currency took place over a period of time, without limitations, and was announced several months in advance. The corresponding reductions in all claims against banks, in other claims and assets, and in wages and prices were not

[9]For details and an independent estimate of a proper conversion rate, see Ames [215] and Baran [216].

[10]See Bornstein [220].

designed to have any real effects on the economy, and particularly not to reduce its liquidity. However, in the Soviet Union, forcing concealed currency hoards into the open was a major purpose of the conversion.

Money: A Passive Planning Tool

From its very beginning, Soviet planning has been based on material balances in which specific kinds of physical resources are allocated in order to achieve goals defined in real units.[11] The basic consumption-investment decisions are made by the state. Production targets are set by the government and embodied in specific directives cast in the form of output plans.

The state-owned sector, which accounts for practically the entire nonagricultural production, consists of administratively independent units ("enterprises") whose manager ("director") is appointed by higher-echelon economic organizations, such as regional or industry branch organizations, currently called *ob'edineniye* (see Ch. 5, footnote 27). The director is responsible for meeting all—including the financial—plan targets after the plan has been approved by the supervisory administration which, however, can make changes after the plan becomes effective. Managers are permitted to increase profits significantly only by raising productivity, but are allowed to have a voice in the allocation of profits. Before the 1965 Reform, only an insignificant part of profits determined by formula was retained by the enterprise generating them. While nominally increasing the enterprise's discretion in disposing of profits, the Reform in actuality did little to increase the firm's autonomy in this area.

Once output plans are set, designated government agencies (typically, ministries responsible for individual industries) specify, for each enterprise or group of enterprises, types and sources of inputs, destination and prices of outputs, and channels of distribution for the outputs. Until limited experimentation with

[11]For one of the earliest discussions of this topic, see Montias [245]. See also Hirsch [120]. Hirsch points out that the directive effects of money "are merely derived from the preceding fundamental material decisions, that they achieve nothing but the optimal execution of the prescribed basic material concept of the plan by consistent measurement and by allocation of economic divisible quantities accordingly."

more flexible policies was begun in 1965, individual enterprises had little scope for deciding between alternative inputs and outputs or investment decisions.

While centrally planned economies are quantity-oriented rather than value-oriented, they do require money to avoid the cumbersomeness of barter.

In a socialist economy, money acquires the additional function of a planning tool, albeit a passive one. To use Brzeski's expression, money is "an organization input in the process of social production."[12] Money enters economic planning mostly as a common denominator for the purpose of aggregation. It facilitates planning by making different activities comparable. Associated financial categories, such as credit and interest, are merely technical devices for implementing central command ("planning") decisions.[13]

Shortages of money cannot be permitted to interfere with the attainment of output targets. At the same time, holdings of extra cash must be prevented from becoming effective demand for labor, raw materials, and other ("funded") inputs in short supply. Since some maneuvering within administratively set limits is possible, the general tendency under the standard system was to convert redundant cash balances into inventory.

The fact that an economic process is programmed in terms of real magnitudes does not necessarily mean that it has no monetary aspects whatever.[14] These monetary aspects are important, but only in a global, macroeconomic sense. Once the macromonetary decisions are taken, what remains is implementation. Much of what appears to be monetary action is, in fact, the exercise of administrative functions by the banking system in support of policies formulated elsewhere. Monetary flows recorded by the banking system reveal deviations from planned real flows and mirror any cumulative disequilibria and bottlenecks in the real processes. Actual performance measured by comparing payments flows with plan figures provides a day-to-day check on the economy—indeed, the only overall check.

Money thus performs an important function as a signal, but is

[12]"Forced-Draft Industrialization in Poland," in [118], p. 23.

[13]Typical Soviet textbooks refer to money as facilitating planning, control of production, and unified and universal accounting. See, for instance, Bogachevsky's textbook [14].

[14]See Ames [99], p. 172.

not relied on to any significant degree as an adjuster. Credit policy is not used as a means of affecting aggregate demand through varying the cost and availability of credit or by manipulating quantity of money and its composition. Instead, demand money is controlled by administrative means—this mechanism differentiates the Soviet system from the market allocation of credit. Administrative decisions, rather than market adjustments, are relied upon to correct deviations from planned performance (targets), to remove bottlenecks, and to correct for any disequilibria that might develop. These decisions are made by the various economic planning and administrative agencies (the "economic organs"), not by the monetary authorities.[15] However, all deviations from planned performance are first signalled by the monetary flows recorded by the banking system.

Financial Planning

Soviet financial planning has failed thus far to integrate planning on the microeconomic (enterprise) and the macroeconomic level. Financial plans prepared for individual enterprises and units of the state sector are aggregated for planning and monitoring purposes (by industry branch, intermediate units of the economic administration, and territorial subdivision), but are integrated neither within a comprehensive national financial plan nor the monetary plans of the State Bank.[16]

The monetary plans that provide the operating basis of the two main departments of the State Bank are the "Credit Plan" (Credit

[15]It is, perhaps, significant that in *Economics of Soviet Planning* [103], by Abram Bergson, one of the leading authorities on the Soviet Economy, there is no chapter on money and banking, and only a perfunctory reference to the banking system: "Another major agency concerned with credit and finance after the Ministry of Finance is the State Bank" (p. 38). Even in Nove's widely used *The Soviet Economy* [137], fewer than four out of the more than 330 pages of the revised edition are devoted to banking and credit. In a chart showing the "organization and powers of central agencies for planning and managing the Soviet economy," Zaleski [157], p. 25, does not include either the State Bank or the Ministry of Finance. College textbooks similarly ignore the role of money and banking. See, for instance, Turgeon [150], although the gap was filled in the second edition. Compare Grossman, "Gold and the Sword: Money in the Soviet Command Economy" in Rosovsky [143].

[16]On the possible use of banking statistics and for a detailed review of the information contained in the various payment documents for economic planning and forecasting, see Belkin [12].

Department) and the "Currency" or "Cash" Plan (Cash Department). The first combines short-term lending with long-term credit, which has shown rapid growth in recent years. While the inventory needs of the state sector can be derived from enterprise financial plans, other credit needs are difficult to ascertain (funds needed to finance the collection float, for example). The Credit Plan, on all territorial levels—local, regional, and central—is thus a combination of identifiable credit requirements projected from past inventory patterns and educated guesses by State Bank officials of the additional amounts required to bridge the collection gap, as well as various other unforeseen needs; it is not broken down on a quarterly basis. The annual Credit Plan is roughly comparable to the global credit ceilings established from time to time by some central banks of Western Europe.

The "Currency" Plan provides the basis for the other main activity of the State Bank—control of currency in circulation. It is derived from a sources-and-uses-of-funds account of the household sector. This account, known as the "Balance of Money Income and Expenditures of the Population," has two parts. The first shows income received from state enterprises, various organizations, government units, and transfer payments from the budget; the second, transactions within the household sector (such as purchase of second-hand goods) and between households and *kolkhozes* (mainly the purchase of food in the free market).

Efforts to identify and increase "sources" of State Bank resources, such as *kolkhoz* deposits, which figure so prominently in the official pronouncements and literature, must be interpreted as a survival of misconceptions about the credit-creating power of the banking system, or as an effort to keep to a minimum additional currency issue caused by credit expansion, or both.

As to financial planning on the micro level, each enterprise operates on the basis of a financial plan which summarizes and expresses in value terms the content of an underlying economic plan formulated in physical terms. The director of the enterprise is responsible for the execution of the plan, which details the enterprise's relationship with the national economic plan, including the disposition of its social income, or surplus.

Lack of differentiation makes it impossible to trace separately financial flows going into fixed investment, increases in working *nomy*

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TABLE 3.1

Sources and Uses of Funds of an Enterprise, as Summarized in Its Financial Plan

Uses	Sources										
	Profits from Principal Activity	Profits from Sale of Consumer Goods Produced as a Side Line	Profits from (and Economies Made in) Construction	Savings Realized on Investment Expenditures	Depreciation	Sale of Unneeded Property	Increase in Accounts Receivable	Reduction of (Unneeded) Working Capital	Parents' Contributions to Operating Kindergartens	Resources Received from the Budget	Total Expenditures
1. Fixed investment	372		20	60	56						508
2. Major repairs					80						80
3. Increase in own working capital	40						4	36			80
4. Fund for increasing output	20				24	12					56
5. Consumption fund		64									64
6. Premium fund	15										15
7. Expenses for kindergartens									20	24	44
8. Fund for cultural purposes	10										10
9. Repayment of long-term loans	16										16
10. Interest on bank loans	1										1
11. Profits paid into budget	114										114
Total receipts	588	64	20	60	160	12	4	36	20	24	988

SOURCE: Plotnikov [68], p. 132.
NOTE: Figures are illustrative.

capital, and gross additions to social infrastructure (public investment, in the Western sense). Table 3.1 shows this lack of differentiation at the enterprise level with a summary (using illustrative figures) of the sources and uses of funds in a typical enterprise under the standard system as it was before the 1965 Reform.

Financial transfers by the enterprise are shown in rows 9 to 11. They consist of payments of part of the profits into the budget, interest payments, and repayments of bank loans (which, prior to the Reform, were charges against gross profits). Rows 1 to 8 cover internal uses of funds.

It is peculiar to Soviet enterprise accounting that the difference between planned and actual expenditures for investment (columns 4 and 5) are considered a source of funds, as are economies achieved in estimated construction expenditures. These sources supplement the depreciation allowances available to finance fixed investment provided for in the central economic plan (line 1, column 12). Another part of the depreciation reserves, together with a deduction from profits and the proceeds from the sale of redundant equipment ("unnecessary property"), is used to acquire equipment and to finance minor construction projects not provided for in the plan. These sources of "decentralized investments" are channeled through one of the special funds (row 4) that the enterprise freely used before the Reform as part of the less differentiated "enterprise" or "directors" fund. Rows 5 and 8 show funds that channel part of the profits into collective consumption of the enterprise, while row 6 represents another special fund, also derived from retained profits, which provides incentive payments (premiums) for the staff. In the case illustrated by Table 3.1, working capital is increased by profits, by a rise in economic receivables, and a reduction in unneeded working capital (columns 2, 8, and 9, respectively). Note that no use of short-term credit is shown, although the use of long-term credit is illustrated.

Since monetary and credit flows are planned as the counterparts of physical flows, financial plans are by necessity derivative. On the one hand, they register and project the effects of planned changes in the level and structure of output and prices on money supply, credit, and investment financing. On the other, they indicate, through the actual changes in the financial variables, the "financial plan fulfillment"—to what extent plan targets are being met. Where "real plans" are the result of compromises among the various central and regional economic and political agencies, the related financial plans reflect automatically the goals set and the compromises struck in these original plans.[17]

In the broadest sense, the unified budget is the most comprehensive financial planning document, since it specifies the amounts of investment grants and credit through the intermediation of the banking system. The other financial plans are, in effect, little more than statements of sources and uses of funds. Some are nothing more than incomplete projections of prospective operations, frequently for periods no longer than one quarter, subject to continuous review and adjustment. Except for the budget, all financial plans are internal documents, so that no outside analysis of their relationship to actual performance is possible.

Adjustments in financial plans, for the longer run as well as in midstream, are made through administrative decisions. They may include changes in growth patterns, as well as adjustments to deal with dislocations and bottlenecks in situations where some enterprises (or economic or geographic sectors) fail to meet plan targets while others manage to exceed them.

The Reform of 1965 has not abolished financial planning, but has made it more flexible and less detailed. Central planning of the broad categories of credit use continues, with the aim of preserving monetary equilibrium by balancing availability of resources and demand.[18]

[17]Financial planning serves a number of specific needs, but so far it has not resulted in the creation of a comprehensive, all-encompassing financial plan that would serve to guide and monitor the progress of growth and the preservation of overall monetary equilibrium. One of the obstacles to the construction of such a plan is the fact that the *kolkhoz* sector remains outside of central financial planning.

The precise role of financial plans in economic planning remains an area of controversy and considerable confusion among Soviet economists, and views differ as to their practical significance. See, for instance, Alexandrov [2], Ch. 2; Allakhverdyan [98]; Batyrev, Kaganov, and Yagodin [11], Ch. 4; Margolin [59], Ch. 1; Shenger [74]; and Zverev [93].

[18]For details, see Allakhverdyan [98] and [161], Isaev [42], Lyando [56], Margolin [59] Plotnikov [68], Ch. 3, Slavnyi [79], and Usoskin [89]. For an official Soviet presentation in English, see Dundukov, "Financial Balances," in [151]. See also Berliner's pioneering study [218], Lushin [55], and Garvy [117] and "The Role of the State Bank in Soviet Planning in Degras" [110]. For a brief history of monetary planning by the State Bank, see Melkov [61], pp. 92–97.

The Limited Role of Prices

Prices depend on administrative decisions rather than on supply and demand factors.[19] They are manipulated by the government as a means of distributing the social product within a broad framework of economic policy.

The authorities set all consumer prices as well as transfer prices for producers' goods and raw materials. They arrive at their price determinations by adding centrally set (average) profit margins and (mostly average) distribution margins to production costs, with no regard to demand or depletion. Goods, from raw materials to final products, are traded on the basis of price lists issued by central planners (the Price Committee attached to the State Planning Committee), which contain about five million individual prices. In 1972 alone the Price Committee had reviewed about 400,000 individual prices.

Since stable prices facilitate planning and an orderly distribution and redistribution of the national product, major revisions are undertaken reluctantly and only at infrequent intervals. A systematic review is usually undertaken to implement new major policy decisions regarding costing and pricing, or to maintain or change price relationships between individual goods or commodity groups. The basic price revision following World War II resulted in wholesale price lists issued in January 1949, which were revised in 1955. The next and more sweeping revision was not undertaken until 1967, after the Reform, which introduced a charge on capital assets, was launched. Individual price adjustments are made typically to cope with shortages of specific goods (and, in some cases, with consumer dissatisfaction) rather than as a systematic reaction to economic impulses received through the market. Occasionally, individual prices are changed and profit margins on certain categories of products adjusted, primarily in order to reduce differentials that are obviously illogical and cause misallocation of resources.

Export prices are divorced from the domestic price level and may be specified in a convertible currency (usually the U.S.

[19]For the rationale and technique of price setting, see Malafeev [57], Smirnov [81], and Zverev [93]. See also Bornstein [222] and Denis and Lavigne [111].

dollar) or in rubles. In the second case (usually in trade exchanges with other socialist countries) applicable prices are differentiated according to various factors characterizing the particular transaction—whether subsidies and premiums are involved, the time at which the original transaction was entered into—and in some cases, depend on the particular export (or import) organization (usually a ministry or its subordinated or special-purpose organization) responsible for the transaction.

Goods are exported at prices that make them competitive abroad. When such prices are lower than domestic costs, the difference is absorbed by a special fund which receives the difference between the price the domestic purchaser must pay for imports and their foreign costs (converted at the official rate). If the required price-equalization export subsidies exceed the amounts accumulated from corresponding payments by importers, the domestic cost of balancing foreign payments is ultimately borne by the budget.[20]

The Soviet price system is thus an inadequate guide for a rational allocation of resources between domestic consumption and exports, or for determining the pattern of trade. Indeed, some Soviet economists have long recognized the existing price system as one of the impediments to an optimal allocation of resources. Therefore, restructuring prices to allow for the cost of capital and, to some extent, for natural rents constituted a significant part of the 1965 Reform. The basis for price setting has been shifted from a literal interpretation of the labor theory of value to factor cost pricing with fixed and largely uniform markups. However, recalculation of prices to allow for the capital use charge and quasi rents did not lead to a restructuring of the entire price system.

Broad adjustments were made during the 1967 general review of wholesale prices and again in 1970, resulting, as in previous general price revisions, in the issuance of new official price lists. But no changes were made in the principles and procedures of central price setting; instead of the introduction of flexible prices that would respond to supply and demand conditions, a set of

[20]Only the net receipts from, or cost of, foreign trade (and service transactions) enter the domestic payments circuit. For further discussion of the impact of foreign trade on the Soviet economy, see Pryor [141].

fixed and immutable prices remained applicable until the next cycle of systematic general price revisions. The new cost factors were allowed for, without revising the basic approach to the pricing of other factors and without correcting the numerous distortions embodied in existing wholesale prices. Neither did raising the average profit markup to 15 percent of prime costs (with greater variations by industry, industrial branch, and even individual enterprise) constitute a significant change, although the resulting increase in wholesale prices (not passed on to retail level) did reduce the number of enterprises requiring subsidies.

One argument for not departing from the principle of fixed prices—in contrast to freeing some price categories either entirely or within stipulated ranges, as in Hungary and some other socialist countries—has been to contribute to a stable environment in which managers of individual enterprises can learn to operate without detailed direction from the central authorities. Frequent administrative changes in prices can play havoc with the planning process. Thus, price lists reflecting revisions effective January 1, 1970 were issued too late to be taken into account in developing the economic plan for that year. The plan was formulated in 1969, with the result that the structure of production in the 1970 plan did not reflect the new price relationships. Interenterprise sales were complicated by the need to carry supplementary accounts to adjust for the differences in the two sets of prices. All billing was in 1969 prices to permit control of plan fulfillment, and the difference between new and old prices required additional settlements between buyer and seller that were entered in separate accounts.[21]

One significant objective of the Soviet price system has been to keep prices of producer's goods low in relation to those of consumer goods. This policy, rooted in a doctrinaire application of the Marxian analysis, has been pursued consistently since the first Five-Year Plan. It was not modified by the Reform beyond the indirect effects of allowing for the cost of capital. In some cases, however, this change had far-reaching effects, since capital-output ratios are typically high in producer's goods industries and many extractive industries. The question of applying the turnover

[21] See Komin [183], p. 21.

tax to producer's goods has also been raised, but so far the Reform has not gone beyond recognizing capital as a cost factor. Nevertheless, the increase in machinery and equipment prices can be viewed, together with the introduction of the capital use tax, as an essential move to counteract one of the most basic weaknesses of the Soviet economy—the wasteful use of capital goods and the general tendency to plan for, and carry, excess capacity.

Before the Reform, when no charge was made for capital because it was public property, considerable misallocation and wasteful use of investment funds resulted, as greater investment per unit of output was not automatically reflected in higher costs. Introduction of quasi rents and of differentiated capital charges has frequently resulted in narrowing the considerable differences in profit rates within the same branch of industry and among its individual products.[22] By introducing a capital use tax and rental payments, the Reform changed the *relative* as well as the absolute cost of goods.

The introduction of markdowns on slow-moving consumer goods was an innovation which acknowledged that inferior or out-of-fashion items could no longer be forced on goods-starved consumers. It became part of the State Bank's lending policy to exert pressure on retail organizations to trim inventories, which in some cases results in sales at a loss (a typical concomitant of relatively low retail markup margins).

The failure of the Reform to come to grips with the problem of price formation sets definite limits on the ability of planning authorities to optimize resource input and of all branches and levels of the economic administration to evaluate performance by individual enterprises and industries.[23]

[22]Shortly before the Reform was initiated, it had been planned to reduce freight tariffs by 20 percent, since under the old system of cost accounting the 1964 profits of the Soviet railway system amounted to 67.2 percent of direct costs. When allowance is made for a charge for fixed and working capital, this profit ratio drops to 12.6 percent, less than the national average for all state-owned enterprises. (It was eventually decided to leave freight tariffs unchanged.) See Kondraschev [184]. See also Mitel'man [193].

[23]In the words of the director in charge of the credit department of the State Bank prior to and after the Reform, "The fact that prices for many products of industry and agriculture do not correspond to the amount of required social labor is a serious obstacle to the use of cost accounting, as audited by the staff of the State Bank, as a tool for analyzing economic processes by the Bank." Barkovsky [168], p. 40.