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The SOVIET FINANCIAL SYSTEM

What it is and how it works

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M. I. BOGOLEPOV

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THIS BOOK IS PRINTED IN COMPLETE CONFORMITY WITH THE AUTHORISED ECONOMY STANDARDS

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Chapter One

THE SOURCE OF STATE FUNDS

1

State Property

FINANCIAL questions constitute one of the most important parts of the general problem of war-time economics and as such have become the subject of intensive attention and study. A knowledge of the financial system which provides a nation with the resources necessary for the prosecution of war is, therefore, of particular interest. Any description of this system is best begun by an examination of the economic sources from which the Exchequer draws its funds. Tackling the problem from this angle is convenient for two reasons: The nation may build up a first-rate financial system but with depleted or poorly organised economic sources, that system may resemble an engine depending on partly filled petrol tanks. On the other hand—and this is particularly important—the structure of any nation's financial system is best judged by examining its financial methods and institutions in the light of its general economic structure. Indeed, in the final analysis it is this economic structure that shapes the basic features of any nation's financial system.

The socialist economic system is the foundation of the Union of Soviet Socialist Republics. This fact is above all reflected in the abolition of private property in the means of production, which now belong either to the State, co-operatives or collective farms, *i.e.*, the property of individual collective farms and co-operative societies.

Today the bulk of the means of production is concentrated in the hands of the State, which owns all the land and its resources. Collective farms receive land allotments for their perpetual tenure, free of charge. The State also owns the waterways, forests, industrial establishments, transport and communication services, as well as large-scale agricultural establishments

set up by the State, public utilities and most of the urban housing. With this property in its hands the State is engaged in large-scale and intricate economic operations which are the basic factor in the general economic life of the country.

This State economy which has now assumed such tremendous scope did not, naturally, emerge all at once. It was, above all, the result of the planned economic policy pursued ever since the foundation of the Soviet State in November, 1917. As late as 1925 small-scale private enterprise accounted for 44.7 per cent of the nation's total productive apparatus, and remnants of capitalist economy accounted for another 6.5 per cent. The Soviet economic structure was during this initial period hampered by survivals of the previous system, but these were overcome with comparative rapidity. The nation's economic structure shifted from one phase to another, its financial system changing accordingly. This is also true of the Soviet Union's financial policy. The economic history of the U.S.S.R. over a period of somewhat less than thirty years, has been particularly rich in rapid dynamic changes both in the economic field and in finance.

The State economy in its present form does not entirely come within the framework of the central financial system. The State economy is the basic component part of the U.S.S.R.'s economic system. The chief point at which the economic and financial systems of the U.S.S.R. merge is in the capital accumulation of State enterprises. The main reason for drawing these accumulations into the country's financial system—and these accumulations constitute the lion's share of the newly-created national income—is the need to distribute these accumulated funds among the various branches of industry and the different regions of a vast country. This distribution is in turn necessary in order to solve the tasks involved in the general plan of economic development. A certain share of this accumulation is not distributed, it remains in the hands of the various branches of industry, furnishing a foundation for independent economic operations by State-owned establishments.

It should be clear, therefore, that not the whole of the national income produced by State-owned economy finds its way into the central financial system, but what is contributed to the system constitutes the larger part of the accumulated funds described above. Since the overwhelming share of financial accumulation is concentrated in the State budget it is only natural that the Soviet budget reaches a very high figure. But this also explains

the rapid and steady growth of the Soviet budget throughout the history of the U.S.S.R. Budget increases are due to the operation of two divergent factors: The constant extension of State economy to new spheres, and the successful development of economic operations by State-owned establishments.

The inclusion of funds accumulated by the huge State-owned economy in the financial system of the U.S.S.R., and the concentration of these funds in the State budget is, perhaps, the most distinguishing feature of the Soviet financial system and of the Soviet budget. Any statistical comparison with financial systems and budgets of other nations is, therefore, precluded. Such comparisons of financial data would lead to misunderstandings rather than to logical conclusions.

The Soviet financial system regards funds accumulated by State-owned establishments as the difference between cost price of goods produced and their wholesale selling prices.

But this means that the price of goods and services is of prime importance for the Soviet financial system. These prices to a large degree determine the size of funds accumulated and contributed to the financial system. But Soviet finance is no less concerned with cost price because, given a stable wholesale price, fluctuations of cost may lower or raise the amounts accumulated. This direct concern of the financial system with the conditions governing production in State-owned establishments makes it necessary for the financial authorities to exercise a certain degree of control over the very process of production. In the process of day-to-day accumulation, the financial institutions serve as a control post, always on the look-out for possible interruptions and disturbances of the productive process. The finance authorities not only record such interruptions, but are in duty bound actively to interfere in the economic functioning of the given establishment and wherever possible rectify shortcomings by adjusting their financial policy accordingly, or by suggesting necessary adjustments to the proper economic authority. Throughout the history of Soviet economy the nation's financial authorities have always served as active controllers of the fulfilment of Soviet economic policy.

The annual plans of economic development devote particular attention to the problem of cost price. The State economic development plan provides that every economic establishment shall systematically lower its production costs. Considering the tremendous scale of productive activity, the lowering of produc-

tion costs, even by 1 or 2 per cent, results in the accumulation of additional hundreds of millions of roubles. These sums are taken into account in the financial plans, the execution of which is the job of the various finance authorities. Such a direct linking up of the economic and financial plans serves to give life to the financial system and makes it a useful factor in the general economic policy of the Soviet Government.

The prices of services and goods produced by State establishments are, within the framework of the socialist economic system, completely free of accidental influences. Hence, prices in the Soviet Union are not subjected to the pressure of so-called market conditions. Wholesale prices, based on actual production costs, are fixed by the Government. Soviet policy with regard to prices is governed by various considerations according to the nature of its particular plans. In this respect it can be said that the prices—at any rate of the most important goods—are dictated by the plan. The determining factor in price policy is, first of all, the desire to ensure the extension of capital resources and, secondly, to raise the general level of the people's welfare. Viewed in that light prices are a powerful instrument for distributing the national income according to a set plan.

The systematic reduction of production costs is closely associated with price policy. While increasing capital accumulation, the simultaneous reduction of prices provides funds with the help of which wholesale prices both of durable and consumers' goods can be lowered.

Direct contact between the work of the financial system and actual production is, therefore, the result of a very considerable and active participation of the controllers of the State financial system in the distribution of the national income.

The financial system has only one means—prices—by which it can collect the accumulated reserves of individual industrial establishments and distribute them according to plan. The prices of goods are broken up into their component elements and certain of these elements entirely, or in part, are absorbed by the financial system.

Prices are first of all divided into two basic parts: Cost price, which covers production and marketing costs and the replacement of basic equipment. The second element is capital accumulation.

Logically this latter element could be entirely contributed to the Exchequer, for the State is the owner of industry. In actual

fact, however, the process is much more complicated. This is necessitated by the following considerations: The State seeks to create among the managers and workers of its establishments a direct interest in the results of their efforts. State-owned establishments are run as juridically independent economic units. Each establishment, having received from the State for its exclusive use both equipment and capital, proceeds to operate on its own, with its own financial accounting, bank account, credit facilities and, finally, with the right to make a profit. In the distribution of this profit the establishment considers its own requirements, contributes a definite sum to the workers' welfare and provides bonuses for good workers.

On the other hand the financial authorities are obliged to cover all State expenditure, and in this the accumulation by various State-owned establishments plays a particularly important part. The State cannot wait for periodical balance sheets to be issued in order to determine how much a given establishment has accumulated.

For this reason the accumulation of factories is usually divided into two parts. One part—often the larger—is contributed to the State budget immediately following the marketing of the factory's products, independent of cost accounting. This part comes into the State budget in the form of a tax known in the Soviet Union as the Turnover Tax. Another part of the accumulated funds, *i.e.*, of the difference between cost price and wholesale price, remains in the factory and constitutes its profit. Now this profit, as well as proceeds from the turnover tax, belongs to the State, but it is handed over to the financial system only in part and in accordance with a special procedure.

Thus, as a rule three elements—cost price, turnover tax and profit—go to make up the wholesale price of goods produced in State-owned establishments.

The combination of these three elements in the price of individual goods, and their relative importance in the price of a given item is not determined by any set standard. In the case of certain commodities all three elements operate, though in widely varying degrees. This is the most typical form of wholesale price. In the case of other commodities only two elements —production cost and profit—go to make up the wholesale price. In individual instances only one element—production cost—determines the price of a commodity, and in other cases wholesale prices are temporarily fixed at a level actually below

production cost. This leads to an operational loss by the establishment concerned; the loss being covered by the State budget.

Such differences in price structure follow from the fact that Soviet policy with regard to prices is but the instrument of general economic policy designed to achieve the aims set by the State Plan and, in the first place, to raise the people's standard of living. Production equipment is marketed at minimum prices which provide the farming communities with cheap tractors, and industry with cheap coal and metal. But since a very large part of what is produced by heavy industry is consumed by State-owned industry which invests tremendous sums in new development, there is, naturally, no reason to maintain prices of durable goods at a high level. Any increase in the price of these goods would call for a corresponding increase in prices of all other goods the production of which involves items manufactured by heavy industry. That is why prices of industrial equipment either do not include the turnover tax or only at a very low rate—in the neighbourhood of 1 per cent. This minimum tax does not, of course, pursue any major fiscal objective, but it does permit financial control to be exercised over production because the turnover tax shows to what extent the given industry is working to plan.

Heavy industry was hardly developed in Tsarist Russia and in fact some branches were non-existent. When the Soviet Government embarked on the industrialisation of the country, and particularly during the Stalin Five-Year Plans, the organisation of many industries, including machine-building, chemical and allied products, had to be started from scratch.

New industries require a certain amount of time to get into their stride, and in this period their production costs are above normal. It would be inexpedient to base wholesale prices on these high production costs, and consequently prices of such products do not include Turnover Tax and profits. Indeed, they do not even cover production costs. But following this initial period, when production methods have been mastered, wholesale prices are based on normal production costs and permit of a normal profit.

The Turnover Tax enables the Government to regulate profits in all branches of State-owned economy. Without this tax, industries whose goods are marketed at a high retail price—alcoholic beverages and tobacco among others—would yield

extraordinarily high profits. This would tend to produce disproportionate advantages compared with other industries and would lead to accumulation of idle capital. Both these defects are obviated by the Turnover Tax.

As a rule the Turnover Tax is paid once for each item. If the given commodity serves as a semi-finished product for another factory then after processing by that factory it may—though not always—again be taxed. The chief criterion is the economic purpose of the tax.

The Turnover Tax is not a price-determining factor, but follows from the prices fixed by plan. In fixing the amount of the tax the prime consideration is the price of the commodity in question. Hence, the technical process is roughly as follows: The tax on a certain commodity is fixed in proportion to its price. For example, if it is planned to market a given commodity at 150 roubles per unit, its production cost being 100 roubles per unit, the Turnover Tax may be fixed at 30 per cent (45 roubles), thus leaving 5 roubles for profit. If considerations of economic policy dictate a lower price, the Turnover Tax is lowered accordingly. Increase of price is accompanied by an increase in tax. In other words, the Turnover Tax is both a method of controlling the accumulation of reserves by State-owned industry and at the same time is a very flexible instrument for carrying out a definite price policy. That is why Turnover Tax rates vary widely.

Budgetary contributions by State-owned establishments, such as transport services not engaged in the manufacture of commodities, take the form of a special tax based on the principle of the Turnover Tax, but more uniform and computed at a lower rate. It is known as the tax on non-commodity operations.

But every establishment keeps a certain proportion of its gross income to cover production costs plus a definite surplus which forms its profit.

Production costs include an average of 3 per cent for replacement of equipment. Taking industry as a whole this adds up to an imposing sum, part of which is used for capital repairs and is under the control of the factory management which deposits it in the State bank. Another part, earmarked for new capital construction, is deposited in other banks which reserve the right to direct it to other branches of industry at their discretion.

Hence, the accumulation of reserves by industrial establishments is closely associated with the basic elements of economic

activity—the fixing of prices and production costs, and through these with the ultimate basis of economic endeavour.

Profits make up the lesser part of accumulated capital. Profits are determined by the economic plans and are based on the average profit yield of the given industry. Needless to say this average differs in the various industries depending on their requirements and need to replenish working capital.

Taken as a whole, the profit of any given industrial plant may consist of two elements. If the plant successfully fulfils its production schedule, surpasses the target figure for productivity per worker and cuts production costs below planned stipulations, or if its volume of output exceeds the plan, its profit is naturally higher than the figure provided for by the plan. There are special rules governing the disposal of such surplus profits.

Profits stipulated in the plan serve as a source for further extension of output and working capital, if such an extension is provided for by the factory management's annual plan. In that case the factory contributes to the State budget its surplus profit. But should its profits prove insufficient for the purposes outlined above, the factory is exempted from contributing to the budget and receives additional budgetary appropriations.

If the factory does not contemplate expansion of industrial capacity in the coming year and is therefore not in need of additional working capital then its entire profit goes into the budget. Similarly, factories with surplus working capital donate their surplus to the budget. This procedure leads to a situation in which the amount transferred to the budget fluctuates from year to year and is therefore fixed at a given sum for each budgetary year. While these contributions vary from plant to plant, industry as a whole turns over to the budget approximately half of its total profits, and maintains control of the other half.

To this should be added that prior to the war, that is up to June, 1941, 2 per cent of all the profits called for by the plan were set aside as a special Director's Fund. This fund included also 50 per cent of all profit over and above the plan, the remaining 50 per cent being subject to the rules stated above for the governing of regular profits.

The Director's Fund was aimed at stimulating production. It was entirely administered by the director of the given plant in accordance with special legislation on the matter. One half of the fund was used for new housing construction for the workers and other employees of the given factory, over and above the

regular appropriations for this purpose. The other half was devoted to cultural and welfare services, such as the organisation of day nurseries, kindergartens, clubs, dining rooms, premiums for meritorious work, bonuses for rationalisation proposals, etc. In some factories the Director's Fund often ran into large sums averaging from 500 to over 1,000 roubles per worker. Since the outbreak of the war the Director's Fund has been replaced by a law which provides factory directors with other means of rewarding outstanding achievements of workers.

So far we have been examining the relations between the financial system and State-owned industry, including transport. Trading establishments do not pay a Turnover Tax, for the commodities they sell have already been subjected to that tax. Trading establishments come under the Turnover Tax only if they maintain their own manufacturing units, the output of which is taxed in accordance with existing rules. Trade profits represent the difference between wholesale and retail prices. Any surplus over expenditure provided for by the plan is turned over to the budget. Retail prices, like wholesale prices, are fixed by the Government.

In the three-year period from 1938 to the end of 1940 the total income of the Soviet State budget amounted to 450 thousand million roubles. Of this sum the Turnover Tax accounted for 283 thousand million roubles and profits from economic enterprises for 48 thousand million roubles. Both these items which represent the accumulation of surplus by State-owned enterprises and co-operative societies, provided the budget with 311 thousand million roubles, or 75 per cent of the total budgetary revenue. Thus three-quarters of the Soviet Union's budgetary revenue represent the results of the economic activities of organisations within the Socialist system.

2

Co-operative and Collective Farm Property

Part of the means of production, which together with State-owned property form the socialist system of economy, belong to co-operative societies and collective farms. This property, and

especially the property of collective farms, furnishes the basis of a vast productive system.

Relations between co-operative and collective farm enterprises and the State financial system rest on a different foundation from those of State-owned establishments. The income of co-operative and collective farm enterprises belongs to these enterprises, to their members, and is distributed in accordance with their constitution and rules. They contribute to the State budget through the income tax.

This, however, does not apply to producers' co-operatives manufacturing goods for the market. In common with other industrial establishments they are subjected to the Turnover Tax, which is necessitated by the fact that Soviet price policy aims at uniform prices on consumers' goods. Co-operative-made commodities sold within the co-operative system do not come under the tax; they are taxed only if sold on the general market.

But the Turnover Tax paid by co-operative societies on goods of their own manufacture is at a lower rate than in the case of State-owned establishments. The idea behind this tax reduction is that producers' co-operatives unite small handicraftsmen formerly working on their own and many of whom continue to operate their own shops. Machinery is usually of the most rudimentary kind, far inferior to the equipment of even the average Soviet industrial plant. Moreover, the raw materials involved are, as a rule, of the lower grades and in many cases left-overs from the larger industrial plants. Moreover, some co-operative societies cater for invalids, pensioners, the blind, etc., and for this reason their production costs are naturally higher than those of the regular factories.

Yet producers' co-operatives account for no small share of the nation's aggregate industrial output. Suffice it to say that in 1937 they placed on the market 13.9 thousand million roubles worth of goods, and in 1940 this figure climbed to 23 thousand million. Co-operative societies work on a profit basis; in 1940 their total profits were in the neighbourhood of 3 thousand million roubles. These profits are subjected to income tax.

Collective farms represent the most clear-cut form of socialist organisation of labour in agriculture. From an economic viewpoint the collectivisation of agriculture amounts to the organisation of large-scale agricultural production in place of midget farms. Large-scale agricultural production permits the widest use of agricultural machinery and of more modern methods of

farming. This in itself testifies to the sharp contrast between collective farming and production by producers' co-operative societies in industry described above.

Two channels link up the State financial system with the collective farms in the process of accumulating financial resources. The first of these is the State tax on the total income of collective farms, and the second—the tax on individual incomes of collective farmers. Both are income taxes and the need for two such taxes is explained by the fact that the collective farmer draws his income from two different sources—the general income of the collective farm, and from other sources. A detailed survey of these will be found elsewhere in this book.

The income of collective farms, and especially their monetary income, is to a large extent connected with State-owned economy which is the main purchaser of collective farm produce. It is only natural, therefore, that collective farm incomes are to a substantial degree shaped by the existing prices of farm produce. The State purchases the produce of collective farms in two ways: By means of obligatory deliveries at low prices; and other purchases at higher, but fixed, prices. The economic policy governing the prices of collective farm produce is based on the vitally important fact that the State provides the collective farms with machinery at a moderate price which often barely covers production costs, and does not include Turnover Tax. Moreover, cheap Government credits make it possible for collective farms to buy costly equipment.

All collective farm produce sold to the State at fixed prices is exempt from the Turnover Tax. Collective farms do not pay this tax even when they sell their produce to other purchasers, for example, to producers' or consumers' co-operative societies, or direct to the consumer. This is one of the very tangible financial privileges enjoyed by the collective farms.

Collective farm incomes in kind are taxed in accordance with two rates. One is 4 per cent of income and covers that part of the collective farm's revenue which consists of products used by the farm itself (seeds, reserve seed funds, food reserves, old age and invalids' relief fund, etc.). Another, higher rate of 8 per cent covers the collective farm revenue distributed among its members. The income tax paid by the individual collective farmer is not, of course, assessed on this part of his income.

The same procedure holds good with regard to monetary incomes. The 4 per cent rate applies to monetary collective

farm incomes derived from sale of farm products to the State. The 8 per cent applies to monetary income derived from the sale of produce on the general market and to revenue from miscellaneous sources.

Under the Soviet system taxes are not only a means of accumulating budgetary resources, but serve as an instrument of economic and social policy. In keeping with this principle the income tax law provides for financial measures to influence collective farm production. Very substantial tax reductions are enjoyed by collective farms organised by peasants settling on new land, or by collective farms which include such settlers. All collective farms in the vast northern areas of the country are exempt from income tax. This was done to encourage the breeding of reindeers, fur-bearing animals, and in general to accelerate economic development in the far north where the efforts of the Soviet Union have met with marked success. The income tax law also provides for reduced taxes or complete tax exemption in the case of collective farms suffering from floods, forest fires, etc.

Income tax receipts from collective farms, though they constitute but a very modest part of the general budget, are a rapidly growing budgetary item. In 1932, they amounted to only 223 million roubles, but in five years this sum had more than doubled—535 million roubles, and in 1940 total receipts were 800 million roubles. This, incidentally, can serve as a positive indication of the rapid growth of collective farm incomes and, consequently, of steadily increasing prosperity on the collective farms.

3

Production Establishments Operated by Individuals

The vast system of socialist economy includes also industrial establishments operated by individuals. These are primarily connected with the collective farms, for every collective farm family has its own house and its own household plot on which it engages in independent farming. The household plot usually consists of a kitchen garden, orchard, several animals and fowls,

and the ownership of small agricultural implements. The produce of this plot is entirely at the disposal of the collective farm family, which is free to dispose of it at market prices.

These household plots are an organic part of the collective farm system, i.e., one of the forms of socialist economy. But the Constitution of the U.S.S.R. also provides for private production establishments not associated with the socialist system. The existence of these establishments is but a modest remnant of that vast ocean of tiny farms and businesses which in recent years has given way to the collective farm and co-operative system. The Constitution, however, makes the existence of these establishments conditional on the complete absence of exploitation of the labour of others.

These small establishments today constitute a very insignificant group of peasant farms and handicraft shops whose owners do not belong to producers' co-operatives.

It is only natural that Soviet financial policy should take a different attitude to these individual establishments, which, while not exploiting the labour of others, are still not part of the socialist system.

The basic principle of every Soviet tax levied on the population is that taxes must be commensurate with income. The income tax in its classic form is applicable in cases when the financial authorities are in a position precisely to determine income. But this is particularly difficult in rural districts where much of the income is received in kind and where the number of tax payers runs into many millions. It has been found more expedient, therefore, to simplify the method of calculating income. Incomes of collective farmers and individual peasant farmers, as well as the incomes of other members of the rural community who maintain farming plots (agronomists, school teachers, foresters, etc.), are subject to a special agricultural tax.

The financial authorities strive, in fixing the amount payable under this tax, to determine the income of each individual. Previously there were set rates for all individual farms, different only in accordance with locality and social category of the tax payer, but now the law demands an individual appraisal of each farm or establishment. In the case of certain republics the law fixes standard income rates for the different agricultural products. Thus, in the R.S.F.S.R. (Russian Soviet Federative Socialist Republic—the largest constituent Republic of the Union) the average income per hectare (2½ acres) of land sown to grain has been fixed at 40 roubles, vineyards at 180 roubles,

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etc. The financial authorities accordingly establish the income of the given farm on the basis of these standards.

This tax, graded on a progressive scale, is applied to all collective farmers and other members of rural communities who, in addition to their regular work, maintain a farm not exceeding the average size of a collective farm household plot. Independent peasant farmers, as well as other citizens with farms exceeding this average, pay a double tax. Their income, however, is computed on the same basis as that of the collective farmer.

The agricultural tax law provides for numerous tax reductions aimed at stimulating economic development and easing possible temporary difficulties encountered by the tax payer.

Handicraftsmen and owners of orchards and kitchen gardens pay their income tax in accordance with their actual earnings and not on the basis of such an estimate.

4

Personal Property and Income

The Constitution of the U.S.S.R. lays down that Soviet law must protect the right of citizens to personal ownership of their incomes from work, their savings, their dwelling houses and subsidiary household economy, and their personal property. The Constitution also provides for the right to inherit such personal property. In the smaller towns a large number of people own their own houses, though most of the larger dwelling houses and blocks of flats belong to the State or municipalities. Citizens of the U.S.S.R. have the right to build out of their savings dwelling houses or summer cottages in the country. People building their own houses are given loans by the State and enjoy certain other privileges.

The personal income of the urban population consists as a rule of wages and salaries. Therefore the level of wages serves as the most important indication of the people's prosperity. In the U.S.S.R. wages cover not only monetary remuneration for work but also the free medical service, kindergartens, nurseries and other children's institutions, rest homes and sanatoria for workers; all organised and maintained at the expense of the

State. However, for the purposes of our survey we shall consider only monetary wages.

Soviet wages policy is based on the Socialist principle formulated in the Constitution: "From each according to his ability, to each according to his work." Wages paid to workers in State enterprises are therefore not dependent on the financial position of the given factory or industry. This means that if for certain reasons the Government decides to increase wages in any branch of industry, the increase is effective throughout the industry regardless of the financial position of any given factory. But individual wages do depend a great deal on the ability and energy displayed by the worker, since the average wage is based on average productivity and is augmented by additional earnings for efforts over and above this average and for improved quality. This explains the need for the income tax which in the main is paid by wage earners. At first glance it would seem that instead of the intricate procedure of collecting taxes on wages it would be far more simple to reduce wages to cover the income tax. But in actual practice wages are not governed merely by a set schedule of rates; they are continually changing according to the worker's individual ability and skill. This is sufficient justification for applying the progressive income tax to this type of income.

The total pay roll of the U.S.S.R. runs into many thousand million roubles. From 82.2 thousand million roubles in 1937 it increased to 125 thousand million roubles in 1940. Income tax revenue from the city population is derived mainly, though not exclusively, from this source. In 1937 total income tax receipts in this category amounted to 1,496,500,000 roubles; in 1940 the figure was 3,677,300,000 roubles constituting some 2 per cent of the total budgetary revenue. Prior to the war the aggregate income tax payments of the entire urban and rural population represented but a very modest share of the nation's revenue. In 1940, for example, this item gave the budget only 9.4 thousand million roubles, or 5.2 per cent of its total revenue. This low relative importance of taxes on individual incomes prior to the war helped to build up a vital potential financial reserve, and when the war strained the nation's financial resources, this reserve stood it in good stead.

The income tax is levied on all personal incomes of industrial workers, office employees, writers, actors and artists, and all categories of what are known as the liberal professions. The

tax also applies to handicraftsmen and that part of the city population with independent income. A law passed during the present war (April 30, 1943) establishes the following income tax rates: Monthly incomes from wages not exceeding 150 roubles are tax free. Incomes of handicraftsmen not belonging to co-operative societies, and incomes from houses are also exempt from the tax, providing they do not exceed 600 roubles per annum. Interest on State loans, savings banks deposits, pensions, salaries of persons serving in the armed forces, incomes of Heroes of the Soviet Union and Heroes of Socialist Labour, and premiums paid to Stalin Prizewinners are not subject to taxation. Persons with three or more dependants are entitled to a 30 per cent reduction on their income tax.

The tax rates are progressive and the progressive scale holds good for incomes up to 1,000 roubles per month, all sums over and above this are taxed at a standard, non-progressive rate. The tax rate for incomes of 200 roubles per month is 2.5 per cent; 400 roubles, 4.5 per cent; 1,000 roubles, 8.2 per cent, and incomes above 1,000 roubles per month, 13 per cent.

The same principle applies to the income of handicraftsmen, but the rates are 10 per cent higher. In the case of persons without fixed salary the rate applied to workers and employees holds good for incomes up to 12,000 roubles. All sums exceeding this figure are taxed at a higher rate.

Individual incomes contribute to state finances not only through the income tax. No small part is played by state loans and savings bank deposits. The revenue derived from state loans is much greater than the income tax receipts. In the Second Five-Year Plan period (1933-1937), the income tax accounted for 17.3 thousand million roubles, while state loans yielded 18.1 thousand million roubles. Up to the outbreak of the present war the people of the Soviet Union had altogether subscribed to state loans to the amount of 50 thousand million roubles. During the same period the total amount of savings bank deposits increased to 7 thousand million roubles.

Budgetary revenue from these sources bears certain specific features. State loans are usually floated to cover budgetary deficits, but the Soviet budget has no deficit, for it is based on the national economic development plan which determines all aspects of economic and financial activity, and rests on the State's material and financial resources. The plan, for instance, takes into account the country's metal resources (consumption

and output plus stocks), its fuel resources, timber and cement stocks, etc. But what is more important from the financial point of view, it takes into account the monetary revenue and expenditure of the population. A balance of this revenue and expenditure furnishes a precise picture of the scale on which the financial means of the population can be mobilised for the fulfilment of economic plans. The economic development plan, based as it is on the material and financial resources of the country, serves as the balance sheet of the nation's economy, and shows what the national income will be and how it will be distributed over the period of the plan. This being the case, there can be no question of a budgetary deficit. But such a deficit is, indeed, theoretically possible, due either to miscalculations in compiling the budget or some unforeseen national calamity, such as crop failure, etc.

All Soviet loans are an integral part of the general plan. Therefore the classification of the Soviet budget as a deficit budget in the League of Nations financial surveys only reveals that the authors of these Surveys fail to grasp the essence of the Soviet financial system.

This can best be illustrated by the following data:

In the Second Five-Year Plan period the government borrowed from the population 18.1 thousand million roubles, and 6.2 thousand million roubles from State savings banks and other State banking institutions, in return for which the latter received State Bonds. Thus, over a period of five years the Government borrowed 24.3 thousand million roubles. The budgetary balance for these five years was: revenue, 362.1 thousand million roubles; and expenditure, 348.5 thousand million roubles. In other words the national budget for five years (including loans) recorded a favourable balance of 13.6 thousand million roubles.

That being the case, the question may arise: Why float loans?

Loans by the State from savings banks, insurance organisations and co-operative societies are raised because these organisations have surplus funds not necessary for their own activities and therefore available for other economic undertakings. These loans are not a means for the re-distribution of the national income, but rather a means of distributing accumulated resources among the various branches of national economy.

Loans subscribed to by the population are on the other hand a means for re-distributing the national income. But first and

foremost they are a source of additional finance, and secondly a successful experiment in encouraging saving by the population. The issue of these loans and their amount depend on the balance of monetary revenue and expenditure by the population, and the policy with regard to money circulation. An excess of budgetary revenue over expenditure actually means a drop in the amount of money in circulation, and serves as one of the factors regulating consumption.

Note should also be made of another problem connected with State loans. Why, it may be asked, have the Soviet people in subscribing to State loans, organised a wide movement in support of such loans? Why have they made the loans nation-wide, involving the whole of the citizens?

Before the war individual subscriptions to State loans were on a modest scale, usually amounting to two, three, or in some cases four weeks' earnings each year. Payment was in instalments over a period of 10 months. This was an inducement to subscribe, and helped to spread subscriptions to all sections of the population. Indeed, State bond-holders numbered many millions.

The first State loan floated on a mass scale involved several million people. In 1927, for example, the State loan brought in 200 million roubles from among 6,000,000 bond holders. Ten years later, in 1937, the number of bond holders topped the 50,00,000 mark and the total sum of subscriptions for that year's loan reached several thousand million roubles.

Several factors contributed to make the State loans into mass loans, particularly after 1927. Among these, mention should be made of the fact that by 1927 the nation's economy had been for the first time rehabilitated since the First World War and Civil War. A new social and economic foundation had been built and the pre-revolutionary level of production had been reached. On the basis of socialist reconstruction and industrialisation, the Soviet economic system was in the process of going over to a new stage of development. This was the beginning of the Five-Year Plan periods which brought with them a rapid growth of cities, the development of culture, and the political re-education of the population. The Five-Year Plans were accompanied by a unique national policy which welded the numerous nationalities of the U.S.S.R. into a united, harmonious family. The success of State loans is primarily due to the general recognition by the population that the

U.S.S.R., as laid down by its Constitution, is a State of workers and peasants. The everyday experience of the people goes to prove that the vast majority of the population have taken up with enthusiasm this work of building a new life. The growth of prosperity and the development of political understanding among the population have been reflected in subscriptions to State loans. These loans have been consequently not only mass financial operations, but at the same time demonstrations of patriotism, of a widespread public movement headed by the trade unions and other civic bodies, including popular committees to foster Government-sponsored loans.

The technical organisation of State loan subscriptions, as well as the payment of interest, etc., is in the hands of a highly-developed network of State Savings Banks.

Soviet loans are issued for a period of 20 years, and usually consist of two categories: Interest-bearing bonds (prior to the war the annual rate of interest was 4 per cent), and non-interest bearing loans providing for a large number of lottery prizes.

The moderate utilisation of taxes levied on personal income before the war, and the comprehensive system of State loans, have proved most useful factors in mobilising the nation's finances during the present war.

The main point, however, is that the Soviet financial system is organically linked up with the economic system of the U.S.S.R. The financial system reflects in every detail changes in the national income. Since these changes are not due to economic crises, Soviet finance develops without complication or hindrance, and its development is consistently successful.

Chapter Two

THE STRUCTURE OF THE SOVIET STATE AND THE FINANCIAL SYSTEM

1

The Uniformity of the Financial System

A UNIFORM financial system is a tremendous asset to any State. This is particularly true in such historic periods as the present one, when events make it necessary for the nation to strain to the utmost all its financial resources. In war-time a rationally organised and uniform financial system is the keystone for the financial mobilisation of the country and a guarantee for the successful financing of the war. But the unity of the Soviet financial system came about not only for reasons dictated by the war. Before the war the Socialist State required a uniform financial system to a no less degree than it does in these eventful days of the war against fascism.

The new Russia was built on the smouldering ruins of the old, of a country whose economic backwardness led to its ruin in the First World War, and the subsequent Civil War, attended as it was by foreign intervention. The young Soviet State was confronted with tremendous problems of rehabilitation of its ruined economy. This work filled the first five years of peaceful creative labour. It was followed by intensive efforts to develop the country's productive forces on the basis both of new political principles and more modern and up-to-date technology. But this called for the solution of extremely intricate financial problems.

Economic development must rest on the foundation of solid financial resources, but these resources had to be procured within the country itself, for at that time foreign loans were out of the question.

The situation thus created demanded a uniform and organisa-

tionally united financial system which, in a Federative State, would facilitate the centralisation of financial resources and their rational distribution among the various branches of industry and the various localities.

Planning, which is one of the underlying principles of the whole Soviet system, provides the prerequisites for a unified planned economic development. Indeed, a multiplicity of plans would in actual practice be equivalent to the negation of planning.

Article 14 of the Constitution of the U.S.S.R. clearly defines the jurisdiction of the State as the master of the country's economy. Among other important tasks, Article 14 lays down that the central government is empowered to sanction plans of economic development, the State budget, and the taxes and revenue forming the Republican and local budgets. Among others the functions of the Central Government authorities include: Supervision of the monetary and credit system of the country, the direction of its foreign trade, based on the State monopoly of foreign trade; the administration of the banks, industrial and agricultural establishments; and the organisation of State insurance, etc. This article also entrusts the Central Government with the planned regulation of State expenditure, formally not under direct Central Government supervision. The Central Government is empowered also to formulate the basic principles with regard to education, public health and labour legislation.

The uniform plan of economic development of the U.S.S.R. makes for unity of the financial system; while the division of administrative functions among the Central Government, constituent Union Republics and local administrative bodies, makes for variety within this organisational unity.

This organisational unity of the Soviet finances is most clearly expressed in the central State budget. From what has been said elsewhere the reader will note that the Soviet budget essentially differs from other national budgets since it includes a very large part of the resources accumulated by the country's industries. But the difference goes further than this. The Soviet national budget includes as totals the budgets of the constituent Union Republics and of all the local government bodies. It is in this form that the national budget is passed by the Supreme Soviet of the U.S.S.R., the supreme legislative body of the country. This amalgamation of all budgets into one all-embracing budget of the U.S.S.R. is by no means a mere feat

of statistics. It is, first of all, the basis for budgetary legislation for the given year, and secondly, from the financial and political point of view, it provides a firm guarantee of the reality of the numerous plans which form the groundwork of the budget.

Inasmuch as the draft of the national budget is drawn up without provision for a deficit, all plans, whether they cover economic development or social or welfare services, must receive in it the financial resources needed for their fulfilment. A favourable budgetary balance is therefore one of the most solid guarantees of the success of the nation's general economic plan as well as of the numerous specific plans which constitute part of the general scheme. The financial resources of the U.S.S.R., as indeed its entire system of finance, can be divided into three separate spheres: Central Government finance; the finances of the various constituent Union Republics; and the finances of local government bodies. The various economic plans, which in their total comprise the annual plan of economic development for the whole of the U.S.S.R., are similarly divided. If, therefore, within the framework of any given republic, or district, financial resources prove inadequate to meet plan requirements, these resources can be supplemented from the central exchequer when the budget is drawn up.

This shows the tremendous value of a uniform financial system which is but a logical result of uniform planning and a uniform economic development throughout the whole of the U.S.S.R. Needless to say the unity of the financial system has stood the country in good stead during the present war, when extraordinary financial efforts are required and greater flexibility and manœuvrability must be displayed both in the accumulation and in the expenditure of all available resources. No doubt experience gained in financing the three Five-Year Plans has helped the Soviet financial authorities to meet the new and varied war-time demands.

2

The Federative System of the U.S.S.R. and its Finances

The unity of the Soviet Union's financial system corresponds to the federative nature of the Soviet State. The financial system is entirely based on the economic system of the U.S.S.R. which,

too, is founded on the federative principle. As already pointed out, the State is master of the country's economy, and this is equally true of the constituent Union Republics which make up the U.S.S.R. The nation's resources are throughout the U.S.S.R. considered as State or Socialist property, divided among the Central Government and Union Republics. But the Central Government does not limit its functions to any specific territory. Its economic efforts, involving colossal annual investments in all branches of industry, are spread over the territory of all the Union Republics. With the absence of private property in the means of production, the fulfilment of economic development plans results in the economic progress of all the Union Republics. It is in the interests of each Union Republic to foster in every possible way the activities of the Central Government on its territory. This has led to a harmonious development of the federal principle in all fields, including finance.

In organising the financial system on federal principles, the Soviet Union has solved three vital problems. First of these was rationally to distribute between the Central and Republican Governments the various sources of revenue. The second was to distribute among them revenue derived from sources controlled by the Central Government. The third problem was to distribute fairly the burden of Government expenditure. The solution of the third problem determined, to a very substantial degree, the policy pursued in solving the first two problems.

The establishment of a federal financial system had to proceed from the fact that the various parts of the former Russian Empire, which now make up the Soviet Union, were in different stages of economic development. Large parts of the Russian Empire, primarily in Middle Asia, were actually colonies of the Russian State, and the Central Government did little to develop them either for lack of funds or out of narrow-minded national considerations. In view of this, the introduction of socialist economy in these districts entailed high expenditure while local resources were very limited.

This to a large extent predetermined the methods employed in establishing a federal financial system in the U.S.S.R.

The distribution of sources of revenue between the Central and Constituent Governments has not, in the case of other countries, obviated an undesirable degree of centralisation of the financial system, and on the other hand, has often led to competition or " tax wars," and to economic rivalry between the various constituent units, each seeking to establish its own

supremacy. The result has been to weaken both their own financial structure as well as that of other constituent units. Many interesting illustrations of this are furnished in "Tax Exemption," a book published by the Tax Policy League of the United States in 1939.

The Soviet Constitution adopted in 1936 proceeds from the principle that the allotting of different sources of revenue to different financial authorities is not expedient. On the contrary, the Soviet Constitution is based on the principle of a united financial system and establishes that "all sources of revenue" irrespective of the budget of which they form part, are approved by the Supreme Soviet of the U.S.S.R. This decision shifts the centre of gravity to the problem of ensuring that there are sufficient resources to develop all branches of the national economy in the many and various localities.

This solution obviates the need for constant and fixed division of revenue. In the case of the U.S.S.R. this division is flexible and subject to change. Its general tendency, however, is that as financial resources increase, and as the financial position of the Union Republics and local soviets improves, an ever-increasing share of budgetary revenue is placed at their disposal.

An examination of how the All-Union revenue is divided reveals that the division is carried out on the basis of the following principles:—

In distributing the revenue from various sources controlled by the Central Government, care is taken to avoid unnecessarily complicated calculations. On the other hand this distribution is aimed at encouraging local bodies to collect all the State revenue due from their area, and a percentage of this revenue is placed at their disposal for their own purposes. This is particularly important because the Central Government does not maintain a special organisation for collecting taxes and depends entirely on the financial bodies of the various republics and particularly of the local soviets. Funds transferred from the central budget to the budgets of the various Republics and local soviets often amount to large sums. Such transfers are made also from the sums received from State loans, for State loans are not regarded as extraordinary budget items, but function parallel with the other sources of revenue. For example, out of the State Loan of 1940, amounting to 9 thousand million roubles, 50 per cent of all subscriptions by the urban population was handed over to the Union Republics, which in turn transferred 50 per cent of that to the local soviets. Of the sum subscribed by the rural population

90 per cent went to the local soviets. It stands to reason that both the Republican and local financial authorities were interested in widely popularising the loan.

Last, but not least, the distribution of revenue among the various budgets is guided by the desire to ensure to each budget a steady and stable revenue increasing as the sources of revenue develop. A stable revenue does not mean merely revenue from one definite source; it includes all annual contributions from those sources which go to make up the various budgets.

It can be said that all the basic items of budgetary income with few exceptions, are divided among the various budgets. One exception is the revenue yielded by customs duties. Another is the income of Machine and Tractor Stations, the whole of which comes into the central budget. Local taxes are entered in the local budgets.

The following table gives an idea of how budgetary revenue is divided among the U.S.S.R. and Republican budgets, which include also local budgets. The figures are for 1940 and are given in thousands of millions of roubles:—

	Union Budget	Republican Budgets	Total
1. Turnover Tax	95.6	10.3	105.9
2 Contributions from profits	12.8	8.9	21.7
3. Income of Machine and Tractor Stations	1.0	1.0	2.0
4. Taxes on the population	1.9	7.5	9.4
5. Local taxes	—	1.9	1.9
6. State loans	6.2	5.3	11.5
7. Income tax on co-operative organisations and non-commodity operations tax	0.2	3.0	3.2
8. Social Insurance funds	6.6	2.0	8.6
9. Customs duties	2.9	—	2.9
10. Other revenues	8.7	4.4	13.1
Total revenue	135.9	44.3	180.2

Note should be made of item 4 which covers taxes paid by the population. The bulk of this revenue comes under the Republican budgets and particularly the local budgets. The Republican budgets also receive a large share of item 2, contributions from profits. The most profitable industries, such as those producing consumers' goods, food industry, etc., come

under the supervision of the various Union Republics, while the Central Government controls heavy industry, manufacturing durable goods which are marketed at prices very close to production costs.

Budgetary expenditure for 1940 is given in the following table (in thousands of millions of roubles):—

Item of Expenditure	U.S.S.R. Budget	Republican and Local Budgets	Total
1. National Economy	49.9	8.4	58.3
2. Welfare and Cultural Services	12.9	28.9	41.8
3. National Defence	56.8	—	56.8
4. Payment of National Debt ..	2.8	—	2.8
5. Other expenditure	9.8	5.7	15.5
Total expenditure	132.2	42.0	175.2

These figures reveal that the overwhelming share of expenditure on Item 1 is concentrated in the central budget and serves mainly for the development of heavy industry, transport and Machine and Tractor Stations. If we add to this the expenditure on National Defence (56.8 thousand million roubles), then the amount received surpasses the entire surplus of central revenue over the revenue of Union Republics and local soviets. In accordance with a decision of the Supreme Soviet of the U.S.S.R. adopted in 1944 Union Republics are to organise their own military formations. This will lead to a new item in their budgets—National Defence—and will increase their budgetary revenue by the appropriate transfers from the budget of the U.S.S.R.

In examining the Republican and local budgets, note should be made of the high percentage (over 65 per cent) of expenditure devoted to welfare and cultural services. This is due to the fact that this item covers such important undertakings as obligatory universal education, medical services, etc.

The Constitution of the U.S.S.R. provides that the general budget of the U.S.S.R. be approved each year by the Supreme Soviet, which also approves the section of the budget dealing exclusively with central finances. This section is examined item by item, both on the revenue and expenditure side. The general budget is taken in groups of items covering the finances of the Republics and local soviets. On the basis of this general budget, which provides for the distribution of revenue among the various

sections of the financial system, the Supreme Soviets of the Union Republics examine and approve their own State budgets and fix the amount of budgetary revenue paid in to the local budgets. Local budgets (regional, district, city and rural), are drawn up by the local soviets who supervise all economic and cultural developments within their given areas.

The Supreme Soviets of the U.S.S.R. and of the Union Republics approve the financial part of the State economic plans, and check the fulfilment of this programme. In other words, through the financial system they exercise control over the entire economic activities of the country. This is the most important and characteristic feature of the wide range of democracy provided by Soviet financial law. The law in no way limits the jurisdiction of Soviet legislative bodies.

It is only natural, therefore, that budget debates in the legislative organs take the form of an assessment of achievements in the economic and cultural fields, analysing the reasons for partial reverses; passing judgment on future plans, and on institutions and persons entrusted with the fulfilment of these plans. This holds good not only with regard to the legislative bodies of the U.S.S.R., but also with regard to the legislatures of the Union Republics.

The economic plans of the U.S.S.R. and Union Republics cover not only industrial and agricultural development, but also numerous measures aimed at promoting culture and public welfare. In this respect the plans reflect one of the basic policies of the U.S.S.R., viz., the comprehensive and rapid development of economically and culturally backward areas. This principle forms the backbone of the Soviet Union's national policy, and is all the more important since the country is inhabited by 102 different nationalities.

In the financial sphere the national policy of the U.S.S.R. finds expression in a more rapid growth of budgetary income and expenditure—both on a Republican and local scale—in districts previously neglected by the Tsarist authorities.

The following figures will suffice to substantiate this point: In the Second Five Year Plan (1933-1937), the unified U.S.S.R. State Budget (which includes the budgets of the U.S.S.R., the Union Republics and the local soviets) increased by 164.1 per cent, the budget of the U.S.S.R., taken alone, registered an increase of 138 per cent, whereas Republican and local budgets increased by 250.9 per cent. What is more, this latter increase was especially marked in the case of the more economically back-

ward Republics: The budget of the Kirghizian S.S.R. increased by 367.7 per cent, the budget of the Kazakh Republic by 405.1 per cent.

The rapid growth of the Republican budgets is characterised by increased expenditure not directly dependent on increased local revenue. This has necessitated higher allocations from the central budget of the U.S.S.R. to the budgets of the various Republics, particularly to the economically more backward ones.

Such allocations were made from sources of revenue which served as a regulating factor in all the budgets, including the general State budget of the U.S.S.R. The most important of these regulating factors is the turnover tax. In 1941 5.3 per cent of the revenue from this tax collected in the R.S.F.S.R. was transferred to the R.S.F.S.R. budget, 57.3 per cent of the revenue collected from it in the Tajik S.S.R. was transferred to that Republic's budget, while in the case of the Kirghiz S.S.R. the figure was 45.3 per cent.

The war did not change this policy. The U.S.S.R. budget for 1944 exceeded the previous year's budget by 17.1 per cent. But the budgets of the Tajik and Kazakh Republics increased by 30.1 per cent and 28.5 per cent respectively.

The national policy of the U.S.S.R. and the financial policy which is based on it, have borne fruit. Apart from the fact that all the peoples of the U.S.S.R. have demonstrated their unity during the war and that soldiers from all nationalities have displayed equal courage and perseverance in combat with the enemy, this planned accelerated economic and cultural development of vast areas in the Eastern parts of the country has proved an important factor during the war. The policy pursued throughout the previous years has enabled the Soviet Government rapidly to establish new industrial centres in these Republics, intensify the extraction and processing of raw materials and fuel, and set up industrial plants evacuated from European Russia. This would, or could, have been entirely impossible in pre-revolutionary Russia, during the First World War. The Soviet national policy has resulted, among other things, in developing a firm and active economic rear, which is one of the decisive factors making for victory.

3

The State Bank

The foundation of the present banking and currency mechanism of the Soviet Union was laid towards the end of 1921, when the State Bank of the U.S.S.R. was instituted, with the right to issue bank notes. By a separate law passed at the same time, the new bank of issue was endowed with the monopoly right to acquire both home-produced and imported gold, as well as other currency metals and foreign currency.

The foundation of the State Bank was the first step towards the reform of the currency, which was completed in 1924 when, in addition to bank notes of comparatively large denominations (the lowest being ten roubles) treasury notes of smaller denominations were introduced. Both forms of currency circulated freely and were exchangeable at par, and both were media of legal payment. Subsequently, when the currency had been definitely stabilised, the State Bank took over the treasury issue, maintaining a regulation cover for the joint issue. The State Bank thus became the sole repository for currency reserves, and the responsible regulator of the entire currency system.

Once the currency had been firmly established, it became possible to introduce a more effectual organisation of short-term and long-term credit. Of the two, short-term credit was the most important problem to tackle, for on its solution the regulation of the production process, and to a large extent the stability of the currency, depended.

In the first ten years or so of its existence, the State Bank was not the only bank engaged in loan finance; there were other, although smaller banks, which had been specially formed to finance definite branches of industry. Furthermore, in addition to bank loans, there was a system of financing by bills of exchange, drawn by one business concern on another. The existence of this system naturally interfered with the utilisation of the banks as instruments of rigid control over the financial activities of business organisations.

Accordingly, in 1930, steps were taken to reform the whole credit system. The reform was based upon two underlying principles: (1) all short-term financing was the exclusive prerogative of the State Bank, and (2) bills of exchange were abolished and no one public business concern had the right to grant credit

to another. All short-term financing thus became bank financing, concentrated in the State Bank, of which all business organisations in the country became direct clients. The other banks were converted into exclusively long-term financing institutions.

Simultaneously, the gigantic job was undertaken of reconstructing the reserves of working funds of enterprises essential for the fulfilment of their production programme. These funds formed part of their assets and were at the full disposal of their management. They were originally provided out of the State budget, or out of the accumulated profits of the enterprise, or from both sources. And it is from either or both of these sources that further working capital has to be provided when the production programme of an enterprise is increased.

But although the producing enterprises now had sufficient working capital to ensure normal operation, nevertheless certain needs for funds arose which they were unable to meet, and which it would have been inexpedient for them to meet out of their working capital. This applies chiefly to expenses involved in purely seasonal production processes, or in the accumulation of seasonal stocks of raw material, fuel, semi-manufactures and the like. These sporadic and purely seasonal expenses are financed by the State Bank, thus obviating the freezing of capital, which would result if the working funds were maintained at a level sufficient to cover seasonal demands.

Furthermore the State Bank finances producing enterprises to the full value of the finished goods between the time they leave the factory to the time they are delivered and paid for. The working funds are thus not tied up while the goods are in transit.

Lastly, the bank comes to the aid of producing enterprises when, as a result of deviations from the production programme in accordance with which the level of working capital was determined, or from other causes not depending on the client (transport difficulties, for instance), their own working capital proves inadequate. If the deviations from the production programme, however, are due to the fault of the enterprise, the bank refuses to supply additional credit, and the financial difficulties of the enterprise become the object of investigation by the competent government authorities.

As bank loans are provided on the basis of an analysis of the borrower's financial and economic position, they have become one of the most valuable and effective forms of control by the Government over the activities of State enterprises.

But there are branches of industry whose production processes are not subject to seasonal fluctuation, or only to an insignificant degree. This would render them practically immune from the control of the bank. As many of these branches—machine-building, for instance—are of great importance to the country's economy, an experiment was recently made in reconstructing the working capital of these non-seasonal industries. A certain part of their working capital is contributed by the bank in repayable form, or rather as revolving credits. Whenever a particular enterprise is constrained to utilise any portion of this part of its working capital, it automatically comes under the control of the bank.

The conditions under which bank loans are made are not governed by hard and fast rules, but are based upon a review of the general conditions prevailing in a given branch of industry. As the rate of interest in a planned economy does not play the role of a regulator of credit, it remains stable at one level for years on end, thus guaranteeing the stability of the credit system and the profits of the bank. These rates at present vary between two per cent and four per cent, depending on the nature of the loans.

The State Bank finances the economy of the country to the amount of many thousand millions of roubles annually. The funds for this purpose are chiefly derived from the free resources of the economy itself, which all flow into the bank as the sole bank of settlement in the country. Every producing enterprise and business organisation is obliged to maintain its cash balances with the State Bank and to make all payments, with the exception of minor sums, through the bank. Enormous funds are thus constantly flowing into the bank, leaving a huge and constantly growing aggregate deposit on account. The economic nature of these deposits should be noted; they consist of the cash resources of the enterprises and organisations of the national economy. Their earnings and profits, as we have mentioned in another place, go into the State budget. The chief item of the State Bank's resources consists, of course, of the deposits on account of producing enterprises, business organisations, collective farms, etc. But another item of no inconsiderable dimensions is the account of the State budget, which in times of peace, besides the usual cash reserve, is swollen by a large excess of revenue over expenditure.

These resources of the State Bank are further supplemented by the bank's own funds, which are derived from budget

assignments and from its own profit, part of which is paid into the budget, while part remains with the bank.

Like every bank of issue, the State Bank has another source of funds in its note issue. Its revenue from this source, which depends on the growth of currency in circulation, is determined not by the plan for financing the national economy, but by what is known as the bank's cash plan. This plan is based upon an estimate of the dynamics of cash transactions, as determined chiefly by factors such as the volume of retail trade, wages, the incidence of taxation, savings, etc., from which the currency policy to be pursued is deduced. The currency in circulation is accordingly either expanded or contracted or left stable.

The State Bank is responsible for the proper drawing up of the cash plan, and by virtue of this it is the regulator and guardian of the internal currency of the country.

The position with regard to the foreign exchange rates of a unit of Soviet currency was simplified by the laws of 1926 and 1928, which prohibited the import and export of Soviet money. In 1936 fixed exchange rates for the rouble were established in respect to the principal foreign currencies. In 1938 the ratio of one United States dollar to five roubles thirty kopeks was laid down as the basis of these fixed rates.

It should be noted, however, that these fixed rates are chiefly intended for the purpose of internal accounting of foreign trade operations, as for example, when a Soviet industrial enterprise, having received machines or other goods purchased abroad, has to record the transaction in its books in Soviet currency.

In multiform transactions with the outside world, on the other hand, it is the practice to conduct all operations in foreign currency. All accounting with foreign countries is conducted through the State Bank which, through its bank correspondents abroad, effects a settlement with foreign clients in foreign currency, while conducting accounts in Soviet currency with its Soviet clients at the fixed rates of exchange. These Soviet clients are the public organisations which exercise the monopoly of foreign trade.

4

Local Democratic Initiative in Soviet Finance

Soviet law does not use the term "local self-government" as is usually applied to local government bodies. The Constitution speaks of "local organs of State power." These local organs are a clear expression of the democratic idea, a true symbol of democratic self-government.

Lenin, founder and organiser of the Soviet State, pointed out that the Soviet State provides the maximum democracy for the workers and peasants. The Stalin Constitution, in describing the social structure of the U.S.S.R., declares that the "Soviets of Working Peoples' Deputies constitute the political foundation of the U.S.S.R." These Soviets are elected by universal suffrage. The supreme organ of State power in the U.S.S.R. is the Supreme Soviet of the U.S.S.R. Local power is in the hands of local soviets of Working Peoples' Deputies elected on the same principle as members of the Supreme Soviets of the U.S.S.R. and the Union Republics. The whole administration of the country from top to bottom is therefore based on the integral principle of self-government.

The Soviet system, in providing for the comprehensive application of the principle of self-government, raises a factor of vital importance for the country's finances. In a State embodying a maximum of democracy there can be no friction between the various spheres of finance; but such friction was common in Tsarist Russia. The existence of a general economic plan precludes the possibility of such friction. The general task of the U.S.S.R.'s whole policy is gradually to enlist the entire working population into the work of administering the State. The solution of this problem depends to a great extent on the work of the local soviets, who rely in their practical work on that part of the electorate which is particularly interested in the country's political and economic life and is prepared to play a part in its day-to-day work.

The rich experience accumulated by the local soviets permits them to perform more complicated functions, both of a general and specific economic nature. The development of the Soviet State, as a result of an intricate historical process, has served to

educate the peasants and workers of Russia politically after being denied any part in administering the country's affairs for centuries. Wide sections of the Soviet population learned from practical experience how to run the affairs of the State, and this led to the appearance of many millions of people actively participating in the work of administrative bodies.

As this experience and knowledge accumulated, the entire system of local government grew and gained strength. Local soviets were able to plan their work on a more solid basis. On the other hand the number of questions under their jurisdiction increased.

The evolution of local government in the U.S.S.R. testifies to the steady extension of its functions and tasks. During recent years the Government has made every endeavour to transfer to local budgets financial operations covering a wider circle of institutions and economic establishments as well as various services which previously came under the supervision of Republican bodies.

Bearing in mind the colossal scope of state-owned economy it is only natural that local administrative bodies devote much of their attention to economic problems. Thus, city soviets have full charge of municipal enterprises and public services, including the bulk of the local housing accommodation and new housing construction. Village soviets cater for local agriculture and for the needs of the collective farmers.

But there is yet another field covered by local administrative bodies which requires much of their attention and activity. This is the vast field of cultural and welfare services. In this respect local soviets are permitted a wide range of initiative and take the main share of responsibility in carrying out the plan of cultural development.

Last, but not least, local soviets have important duties to perform with respect to finance. They have been entrusted, among other things, with the collection of all revenue coming under the Republican and local budgets.

All of this has combined to stimulate a steady increase in local budgets, the rate of increase being far above that of the U.S.S.R. and Republican budgets.

The development of local budgets is traced in the following table:—

	Thousands of millions of roubles		Thousands of millions of roubles
1932	5.9	1937	22.0
1933	6.8	1938	26.3
1934	9.0	1939	28.1
1935	13.3	1940	30.5
1936	18.6		

By way of characterising the revenue of local budgets it may be pointed out that in 1935, for example, out of a total of 13.3 thousand million roubles, 4.4 thousand million were received from local sources (profits of economic establishments, taxes, etc.), and 8.9 thousand million roubles were transferred to local budgets from the U.S.S.R. and Republican budgets. In 1940 the aggregate revenue of local budgets amounted to 30.5 thousand million roubles, of which 14.8 thousand million roubles were derived from local sources and 15.7 thousand million roubles donated from the U.S.S.R. and Republican budgets.

These figures show that increased activities by local soviets are by no means dependent on their sources of revenue, and that the Soviet financial system makes every endeavour to foster such increased activities.

In 1940 local soviets disposed of their 30.5 thousand million rouble budgetary income as follows: 5 thousand million roubles were allocated for economic development, 21.2 thousand million roubles for social and welfare services, and 4.3 thousand million roubles for administrative and other expenses.

Local soviets play their part—and a very important one—in the nation's war effort. In districts liberated from enemy occupation they are now tackling the formidable task of rebuilding industrial and welfare establishments destroyed by the Nazis, who systematically demolished every building even remotely connected with the welfare requirements of the population.

Chapter Three

SOVIET FINANCES AND THE DEVELOPMENT OF THE COUNTRY

1

The Rehabilitation of the National Economy following the First World War

THE courage and fighting spirit of the Soviet armies in battle have evoked amazement and admiration throughout the world. Russia's armies come from the whole people, which supplies its fighters with food and weapons and which justly shares in their glory.

The march of events on the Russian-German front came as a surprise to the enemies of the Soviet Union. They had expected something altogether different, and these expectations revealed an utter inability to understand the development of the Soviet State, its people, and their economy in the relatively short period between the First and Second World Wars.

For the Soviet Union the 25 years which preceded the present war against fascism were no ordinary years. They were years of tremendous creative effort on the part of the Soviet population, efforts which were crowned by outstanding results. The Soviet Union has every reason to consider this period a heroic one. The detailed history of these inter-war years has yet to be written, but the historian who sets out to do so will undoubtedly point to the enthusiasm and energy which inspired every effort of Russia's population in building up a new State and a new economy. Lenin referred in 1920, when the country at long last could get down to constructive work, to the "unprecedented spirit of self-sacrifice" of Russia's working folk in their struggle for freedom.

This spirit of self-sacrifice which even lent an atmosphere of

heroism to the pre-war period, is characteristic of every-day life in the Soviet Union. Peace-time construction had assumed tremendous proportions by the time that Hitler, who entirely misread the Soviet Union's history, ordered his carefully prepared Wehrmacht to invade.

Now that the final collapse of fascism is within sight, the country is confronted with the highly complicated problem of rebuilding its economy. It is therefore pertinent to recall the reconstruction period which followed the war of 1914-18, and the ensuing Civil War and foreign intervention.

Even prior to the November Revolution of 1917, Russia, during her last year as a beligerent, found herself gripped in an economic crisis. An acute shortage of fuel, metal, grain; the dislocation of the transport system; poverty among the population—all these factors had brought the country to the brink of an abyss. Russia retired from the war, but this did not deliver her from her misfortunes. The close of the Civil War, it seemed, furnished an opportunity for rehabilitation, but this possibility was again postponed by the outbreak of war with Poland. Strictly speaking, only 1923 can be regarded as the first normal post-war year.

Even so this normality must be understood only as denoting the absence of foreign and civil war. In all other respects Russia was very far from normal. The gross output of heavy industry was only 30 per cent of the 1913 figure, while iron output was a mere 7 per cent of pre-war. Crop areas and harvest returns were barely two-thirds of the pre-war level. In the sphere of finance, the paper money then in circulation amounted to only 9 per cent of the pre-war circulation in terms of stable gold currency. The country's financial resources, the need for which was so great, did not exceed 42 per cent of the pre-war budget.

Economic rehabilitation may be regarded as the re-establishment of the **status quo ante bellum.** But in the Soviet Union it was not as simple as that, for rehabilitation involved the reconstruction of the entire economic system along new lines. It should be mentioned that the pre-war level of production was restored with a universal 8-hour day throughout industry and a complete absence of home or foreign credits.

The financial system was in a particularly difficult position, for there could be no question of returning to the old system, which in no way corresponded to the new social, State and economic structure. The financial system had to be built anew, from the ground up, with due regard to entirely new conditions

and tasks, and in an extremely unfavourable situation in the sphere of money circulation. Yet the Government could not ignore the financial factor as an important instrument in carrying through its new economic and social objectives, in promoting those classes which were engaged in building a new life and in combating the remnants—at that time still relatively numerous—of the old order.

The economic task of rehabilitation, arithmetically speaking, amounted to restoring the 1913 level in the shortest possible time. This was accomplished by 1926, but in itself could not be an occasion for celebration, for the 1913 indices were nothing to boast of, either for 1913 or, indeed, for 1926. By that time the country has set itself new and far greater goals. But nevertheless the completion of rehabilitation was an important landmark in Soviet economic history, for it signified that the conditions had been created without which the normal process of production and the possibility of extended capital development would have been out of the question.

During these years of reconstruction the Soviet budget grew rapidly. The revenue of both the Soviet and Republican budgets increased from 2.3 thousand million roubles in 1923-24 (the budgetary year was then from October 1 to September 30), to 4 thousand million roubles in 1925-26, in which year income from State property and enterprise amounted to nearly 2 thousand million roubles. Tax revenue was also partly made up of contributions from State enterprises, which then paid several taxes. In 1930 these taxes were abolished and the turnover tax introduced.

During three years of intensive economic reconstruction the State budget accumulated 9.3 thousand million roubles in addition to 2.5 thousand million roubles accumulated by local budgets. Out of the sum of almost 12 thousand million roubles thus accumulated, more than half was directed to financing economic development.

The Soviet financial system thus served as an important instrument in distributing the national income in order to fulfil the difficult and intricate plan of rebuilding industry with the country's own means and resources alone.

A graphic example of this economic revival in Russia was provided by the monetary reform introduced in 1924, which gave the country a stable currency in the form of State bank notes, backed by the bank's gold reserve and commercial assets. The budget was balanced without the additional treasury note

issues which had been necessary at the beginning of the reconstruction period. The U.S.S.R. was, incidentally, one of the first countries to introduce a stable currency following the post-war deluge of paper money which flooded the greater part of Europe.

The 1924 reform not only created favourable conditions for economic development, and particularly for the further evolution of Soviet finance, but accomplished much more. At the beginning of the reconstruction period a vast volume of practically worthless paper money was in circulation. In terms of gold this mass of paper was probably worth less than 100 million roubles. The country was in need of sound money and the State Bank, soon after its organisation, issued its own bank notes to meet economic requirements. This bank issue, in no way connected with budgetary requirements, provided additional hundreds of millions of roubles for building up the new economic system. Meanwhile, the development of numerous credit institutions permitted a more rational utilisation of free financial resources and thus brought into being a new source from which the national economy could draw for its reconstruction work.

2

Finance and the Industrialisation of the Country

The successful completion of rehabilitation established a bridgehead, so to speak, from which large-scale activities aimed at industrialising our vast country could be launched. This aim was indeed the backbone of the country's entire economic policy right up to the Nazis' perfidious attack on June 22, 1941.

The Soviet Union's comprehensive plan of industrialisation is comprised in the three well-known Stalin Five-Year Plans of economic development. The epoch of the Five-Year Plans began in the autumn of 1928, and was abruptly cut off in the summer of 1941, just when the whole nation was working on the fourth annual programme of the Third Five-Year Plan.

In the rehabilitation period the basic task was to organise production and capital accumulation. The solution of this problem was to a great extent aided by the fact that the country had at its disposal numerous idle industrial establishments which

after capital repairs could resume production. The industrialisation period called for new capital investments on a scale hitherto unknown, and not only in industry but in agriculture and every other field of economic endeavour as well.

The fact that by 1928 the Soviet financial system already united both budgetary and credit methods of mobilising the national income facilitated the operation of the First Five-Year Plan. By 1928 Soviet finance had proved that the existing methods of distributing the national income could be applied to the fulfilment of economic plans. The most vital aspect of this problem was to divide current national income into two portions: One to cover current expenditure and the other to cover capital investment. The financial problem of the Five-Year Plan was to ensure adequate funds for carrying out large-scale capital construction, and the efficient way in which the financial authorities coped with this task of distributing the national income guaranteed that such funds would be forthcoming for the realisation of the carefully elaborated and vast plans.

The country's international position was in no way conducive to the fulfilment of the First Five-Year Plan. The World Economic Crisis which broke out in 1929, which hovered over Europe and America till 1932, when it gave way only to a period of prolonged economic depression, could not, of course, involve Soviet economy since the accidental factors in Soviet economic life had been to a great extent overcome.

Nevertheless, the economic recession abroad could not but affect Russia's economic contacts with other countries. This was due, first of all, to the sharp drop in world trade, and secondly, to a similar drop in the prices of agricultural produce and raw materials which formed the basic items of Soviet export at that time. The drop in these prices was greater than in the case of durable goods, which then made up the bulk of Soviet Russia's imports.

This was a definite handicap and the need to overcome it made even more necessary a purposeful and rational distribution of the national income in order to fulfil the industrialisation plan. In 1930 two important reforms were introduced, the financial and the credit reforms. These, as a whole, provided the country with an effective financial system, the basic features of which have been maintained to the present day and have proved their worth both in the course of three Five-Year Plans as well as during the present war.

In developing the first economic programmes under the Five-Year Plans, the chief difficulty lay in the fact that large-scale investments in industry and other economic undertakings could not yield tangible economic and financial results within the near future. Many new construction projects would be completed only after the First Five-Year Plan period. Under these conditions foreign credits could serve as an additional source of finance, but precisely during the years of the First Five-Year Plan there was little hope of procuring such credits. Apart from other vital reasons, recourse to this source was precluded, because at that time the investment markets were in chaos due to the world economic crisis. Consequently, all financial calculations had to be based entirely on the country's own resources.

Accumulation by Socialist economy was organised with the aid of the financial system, and the greater part of the accumulated funds were turned over to the State. The next task was to accelerate the process of accumulation. This was successfully accomplished by systematically fostering the increased productivity of labour which, in turn, led to a considerable cut in production costs and building costs. The steady cut in commodity prices, which lagged behind production costs, helped to increase the accumulation of reserves by state-owned establishments.

The number of workers and employees more than doubled during the First Five-Year Plan, and by 1932 was twice as high as in 1913. This in itself produced very tangible results in the national income which (reckoning in stable prices) increased 86 per cent in five years, and reached 45.5 thousand million roubles at the close of the First Five-Year Plan. Unemployment was completely wiped out. But the First Five-Year Plan led not only to increased employment, it improved the quality of work performed, so that in comparison with 1913 the average annual productivity per worker in heavy industry almost doubled.

This increased labour productivity was based, of course, on improved technical equipment. But in addition to this purely economic factor an important part was played by the political and social structure of Soviet society. Increased labour productivity was in many respects a direct outcome of the enthusiasm which permeated the workers and peasants of Soviet Russia, an enthusiasm which led to lively emulation between factories, mills, collective farms, districts, railways, etc.

The financial results of the First Five-Year Plan may be judged from the fact that whereas the plan called for a total

accumulation of 70.9 thousand million roubles for the five years, actual accumulation amounted to 89.9 thousand million roubles for four and a half years. These funds served as the basic source of finance for the first five-year programme, which called for a total expenditure of over 120 thousand million roubles. Accumulation by socialised economy comprised no less than 75 per cent of this figure. The State budget was the chief factor in financing the Five-Year Plan; it accounted for 61 per cent of all funds invested in the fulfilment of the programme.

The financial tasks confronting the country in the Second and Third Five-Year Plans (despite the fact that these plans called for greater outlay) were solved without the difficulties which were inevitable in the initial period of large-scale industrialisation. Capital investments under the First Five-Year Plan had now been transformed into new factories, power plants, railway rolling stock, machine tools, tractors, etc. The national income increased rapidly, making it easier for the financial authorities to finance the further industrialisation of the country. At the same time note should be made of the valuable experience gained in planning as well as in the construction and operation of new plants.

The First Five-Year Plan resulted in 60 thousand million roubles being invested in the nation's economy. Under the Second Five-Year Plan (1933-37), capital investments were fixed at 114.7 thousand million roubles. Thus 174.7 thousand million roubles invested in national economy over a period of ten years created a solid foundation for further constructive efforts by the Soviet people. It should be pointed out that prior to the First Five-Year Plan the total capital investments had amounted to only 26.5 thousand million roubles. The Third Five-Year Plan (1938-42), provided for capital investments of 192 thousand million roubles. The successful fulfilment of this programme was hampered first by the outbreak of war in Europe in 1939 and later by Nazi Germany's attack in 1941.

There can be no doubt that the heroic resistance put up by the Soviet army and the Soviet people can be traced to those heroic pre-war days when the whole of the vast country under Joseph Stalin's brilliant leadership was being rapidly re-shaped from an agrarian into a modern industrial nation. The Soviet financial system, tested in the solution of the difficult tasks involved in peace-time construction, proved a reliable instrument and effective weapon throughout the difficult war years.

3

Soviet Finance and the Cultural Revolution

Appropriations for cultural and welfare services form the second largest item, after allocations for economic development, both in the U.S.S.R. Budget and the general financial plan which embodies all sources of finance, budgetary and non-budgetary. In this connection note should be made of the following fact: Though the State budget of the U.S.S.R. had reached the 1913 figure only by 1926, the budgetary appropriations for public education had already in the early '20s greatly surpassed the 1913 level, notwithstanding the fact that the general budget at that time was only one-third of the 1913 figure. This concern for cultural development runs through the whole of Soviet history and, as indicated elsewhere, has remained in force even during the trying years of the Great Patriotic War.

Under the First Five-Year Plan, cultural and welfare services were allotted almost 24 thousand million roubles, a sum which was subsequently tripled under the Second Five-Year Plan. Even larger sums were fixed in the Third Five-Year Plan, since the rapidly rising national income permitted an equally rapid expansion in this field.

In the First Five-Year Plan the country successfully solved the most difficult and costly problem of introducing elementary education in the native languages of the various peoples of the U.S.S.R. It was during this period that unemployment was finally wiped out, a circumstance which freed considerable sums formerly paid out in unemployment benefit for use in other cultural fields.

The funds required for cultural and welfare services and institutions are drawn from various sources among which budgetary sources, particularly Union Republican and local budgets, play an important part. Another vital source lies in the funds at the disposal of the trade unions, which increase simultaneously with the growth of the total payroll. Trade union dues amount on the average to 1 per cent of the members' earnings.

Trade unions have developed a variety of cultural and educational activities among their members. Workers and employees of Soviet factories and offices devote much of their leisure to

trade union and other civic activities. The trade unions organise foreign language classes and circles for the study of economic and political questions. But these do not even partially cover their varied activities, which include amateur concerts and theatricals, moving pictures, needlework circles, etc. Sports—ranging from chess to heavy athletics—are also part of their activities, as are the teaching of music, dancing, etc. The trade unions contribute to the organisation of libraries, reading rooms, athletic fields, and recreation centres attached to the various industrial enterprises.

Co-operative societies, too, devote considerable sums to cultural work among their members. In state-owned factories part of the Director's Fund, described already, is used for cultural services. Large sums for the same purpose are allotted by various civic organisations and, primarily, sports societies.

In the villages, following the radical reorganisation of agriculture, cultural activities developed on a large scale. Collective farms contribute no mean sum to the nation's funds from which cultural and welfare services are financed. In this respect they closely co-operate with the village soviets, the bulk of whose budgets are devoted to cultural activities.

The improved living standards of the collective farmers serve as the material base for the growing cultural activities of the countryside. Every collective farm deems it its duty to set up a club or reading room which provides facilities both for education and recreation.

The growing expenditure from State and civic funds for cultural purposes is accompanied by similarly growing expenditure by the population. Soviet newspapers, magazines and books are sold in millions of copies and distributed through a wide network of libraries, reading rooms and book stores.

These and numerous other facts will show the impartial observer the scope of the cultural revolution carried out in the country. Democracy in the social sphere, which constitutes the basis of the Soviet political system, has found striking expression in the cultural life of the country. One of the most vivid features of cultural life in the U.S.S.R. is the desire of wide sections of the population to gain knowledge of the great cultural treasures accumulated through the ages by their own and other nations.

In public education the task confronting the country after elementary schooling had been introduced was to implement general secondary education—the 7 and 10-year course—in urban districts. This task has been fulfilled successfully.

The development of medical services has proceeded along two lines: Provision of more comprehensive medical assistance to the population—the number of doctors in the country increased from 19,800 in 1913, to 90,700 in 1936; and measures to prevent disease and raise the general health standard of the population.

Soviet legislation grants many privileges to expectant mothers. The Soviet laws on mother and child welfare were substantially augmented in 1944 by extending pre-maternity leave to 35 days and post-maternity leave to 42 days. Rations allowed to expectant and nursing mothers have been doubled, and the law forbids overtime work for pregnant women and night work for nursing mothers. The law also provides for a special monetary grant to mothers, organisation of extra day nurseries, kindergartens, summer camps for children, pre-school education, etc. Expenditure on public health (all health services in the U.S.S.R. are free of charge), runs into thousands of millions of roubles, not counting the enormous sums spent on the maintenance of sanatoria, rest homes, health resorts and similar institutions.

The social insurance fund, which is made up entirely of State-donated sums has reached imposing dimensions. In 1940 the income of this fund, which is included in the general State budget, amounted to 8.6 thousand million roubles. The fund is used for the payment of pensions and sick benefits, for rehabilitation of invalids, maintenance of invalid homes, payment of grants to mothers of large families, etc. It is interesting to note that the latter item alone accounts for over one thousand million roubles per year.

Two figures serve to illustrate Soviet policy in this respect: In 1940 the total taxes paid by the population plus subscriptions to State loans furnished the budget with 18.4 thousand million roubles, while budgetary expenditure on cultural and welfare services alone amounted to 40.9 thousand million roubles.

Chapter Four

SOVIET FINANCE IN WARTIME

THE tense political situation throughout the world, which became particularly acute towards the close of the 1930s, compelled the Soviet Government to take precautionary measures and strengthen its national defence. This naturally resulted in increased expenditure on defence which, in a way, can be regarded as the "overhead expenses" of peaceful construction and cultural development.

Prior to this period the main factor determining the scope of national defence expenditure was the geographical one. The Soviet Union had to ensure the defence of a vast country spread over two continents with a total area of 8.3 million square miles, with frontiers stretching for 40,000 miles and bordering on 14 countries. Only the most northerly sector of this frontier—the Arctic coast—has its own natural defences. Everywhere else the guarding of the State frontiers required the outlay of large sums.

Budgetary expenditure on this item cannot be taken as a criterion of the country's defence capacity. In fact, it must be regarded merely as the overhead expenses. A country's defensive capacity is made up of the numerous factors which contribute to its economic potential. Judged in that light, the Soviet Union was able greatly to enhance its defensive capacity by the close of the First Five-Year Plan, by which time the foundations of its industrial might were laid. The degree of industrialisation achieved by 1932 made it possible to produce modern weapons of war on a mass scale. Subsequent years brought with them industrialisation on an even greater scale and consolidated the economic basis of the Soviet Union's defensive capacity.

The Soviet Government's expenditure on its Army, Navy and Air Force during the Second Five-Year Plan was kept at a minimum. Indeed, aggregate expenditure on the fighting services throughout the Second Five-Year Plan (1933-37), was less than expenditure for the last pre-war year, 1940, when the Second World War was already raging in Europe. It should be remembered that even during the Second Five-Year Plan the international situation was tense, and was marked by the Nazis' advent to power in Germany.

War broke out in 1939 and compelled all nations to take precautionary measures. The draft State budget of the U.S.S.R. for 1941, submitted for approval to the Supreme Soviet, contained provisions for 70.9 thousand million roubles expenditure on national defence. This proposal evoked unanimous approval in both legislative chambers, since it was obvious that the danger of war was nearing Russia's frontiers.

The fateful hour struck on June 22, 1941, when Hitler's armed hordes treacherously attacked across the Western boundary of the U.S.S.R. War had begun. The financial system was confronted with the new task of providing the funds for the successful prosecution of the war. Soviet finance displayed a high degree of manœuvrability in re-directing the nation's financial resources to the achievement of new objectives. The outbreak of war came at a particularly unfavourable time, since the enemy was able to utilise the advantage of sudden attack, capture large tracts of European Russia, and approach Moscow, the heart of the country. For the financial authorities this meant first of all the loss of important sources of budgetary revenue.

As the 1941 budget had already provided for substantial defence expenditure, military appropriations during the second half of that year surpassed the original budget figure by only 20.6 thousand million roubles. This figure, as well as others pertaining to war expenditure and cited in this book, include only budgetary appropriations for the People's Commissariat of Defence and the People's Commissariat of the Navy. In addition to these purely military appropriations, the State budget provided a large share of other expenditure associated with the conversion of industry for war needs, evacuation of industrial plants to Eastern regions and the organisation of new war factories. The budget also pays out pensions and grants to Servicemen and their families. All these expenses connected with the nation's war effort are entered under the various items dealing with economic and cultural expenditure.

The 1941 budget fixed appropriations for the army and navy at 70.9 thousand million roubles, or approximately 36 thousand million roubles for the half year. Actually, however, during the second half of 1941 expenditure under this item was 20.6 thousand million roubles above the planned figure, or roughly 307 million roubles per day. But it was clear that this figure would grow as military operations developed and this confronted the financial authorities with the dual task of fully meeting all war expenditure and making good the loss of

budgetary revenue resulting from the occupation of several regions by the enemy.

In the first half year of the war this task was solved primarily by cutting expenditure on economic development by 21.6 thousand million roubles, and on cultural and welfare services by 16.5 thousand million roubles. At the same time measures were taken to find new sources of revenue. A description of these measures is given elsewhere in this book.

The 1941 budget which called for a total of 216 thousand million roubles, actually produced only 191.4 thousand million roubles. But, nevertheless, Hitler's plan of disrupting Soviet finance and economy by occupying the country's richest agricultural and industrial districts, and thus undermining its economic might, failed, and this failure was evident even in 1941. The Soviet Union's pre-war economic policy was aimed at industrialising all districts of the vast country and in bringing the previously backward Eastern districts up to the standard of the more highly developed central industrial regions. The systematic implementation of this policy proved a vital factor in the difficult days of total war.

The sum total of the 1942 budget was fixed at 182.8 thousand million roubles, of which 108.4 thousand million, or 60 per cent, were earmarked for the war effort. Average daily war expenditure thus amounted to 297 million roubles, or roughly the same as for the first half year of the war.

The 1943 budget showed a total of 209.7 thousand million roubles, of which 124.7 thousand million roubles (60 per cent of aggregate expenditure), went for war purposes. Average daily war expenditure increased by some 14 per cent to 340 million roubles. But by 1943 additional financial resources had been created, and this increase of 14 per cent caused no difficulty to the nation's finances.

But each war year bears its own specific imprint. In 1943 the Nazis were ousted from a large part of occupied territory. This drive against the enemy became the backbone of Soviet strategy, which during a comparatively short period yielded amazing results. 1943 was marked by crushing defeats of the Germans at Stalingrad and Kursk.

The territory liberated from the Nazi barbarians was completely devastated. Everything that could be destroyed by fire had been razed to the ground. In the R.S.F.S.R. alone the Germans destroyed over 500 towns and workers' settlements, and over 14,000 villages and hamlets. At the peak of their

advance on Moscow Hitler's armies occupied 42 per cent of Moscow Province, and burned 2,280 villages and hamlets, several cities, completely destroyed 47,246 collective farm cottages, and over 12,000 larger dwelling houses and blocks of flats in the towns. In Moscow Province alone they destroyed over 165,000 agricultural machines and implements. Many first-rate industrial plants were either completely or partially ruined. In one part of the Moscow Province alone an official estimate of the damage caused is placed at 7 thousand million roubles. In addition to this the Germans destroyed over 15 thousand million roubles worth of the property belonging to Soviet citizens. This is but one example of German vandalism, yet it graphically illustrates the scale of Nazi loot and destruction. Moreover, all of these calculations do not, and indeed cannot, take into account the number of killed, crippled and enslaved people, and their incalculable sorrows, privations and suffering.

The liberation of Soviet territory which proceeded at a rapid rate in 1943 confronted the financial authorities with yet a new task, the provision of adequate means for rehabilitation. Appropriations for this purpose came under the heading either of economic development, or of cultural and welfare services if the funds were intended for the rebuilding of schools, hospitals and so forth.

This item formed no small share of the 1943 budget and assumed even greater proportions in the 1944 budget.

The U.S.S.R. budget for 1944 provides for a total expenditure of 249.6 thousand million roubles, of which 128.4 thousand million roubles or 51 per cent, make up the war expenditure. Thus, average daily war expenditure amounts to 350 million roubles.

The war effort consumes over half of the nation's budgetary revenue, and this has necessitated a radical change in the structure of the budget, particularly on its revenue side.

In common with peace-time years accumulation of reserves by State-owned enterprises, augmented by similar accumulations by co-operative establishments, still form the foundation of the U.S.S.R.'s budgetary revenue. But today the taxes on the personal income of the population, as well as mass State loans and voluntary donations to the State, both individual and collective, play a far more important part.

Accumulation by State-owned and co-operative enterprises records a steady increase since the outbreak of the war. From

109.9 thousand million roubles in 1942 this item climbed to 132 thousand million roubles in 1943 and is planned to reach 148.6 thousand million roubles, or 61 per cent of all budgetary revenue, in 1944. One of the main reasons for this rapid growth is the conversion of State-owned industry to war purposes, and the fact that this industry was able in record time to master improved methods of production which enabled it drastically to cut costs. This slashing of production costs in the war industries has led to a considerable economy in war expenditure. Up to 1944 this item alone saved the budget 35 thousand million roubles which means 35 thousand million roubles of additional accumulation by State-owned enterprises.

Contributions by the population are another important factor. In 1942 such contributions amounted to 42.2 thousand million roubles, of which about one-half were voluntary donations. In the following year this item yielded 55.4 thousand million roubles, and in 1944 it is expected to bring in 62.8 thousand million roubles, or approximately 16 per cent of the total budgetary income.

Taxes levelled on the population were increased, particularly by the introduction of a special war tax, followed later by a tax on single persons and childless families, an increase in the agricultural tax and in miscellaneous local levies.

The war tax introduced by the Act of December 29, 1941, applies to all citizens of the U.S.S.R. of both sexes over the age of 18. Persons of military age but exempt from military service pay 50 per cent higher taxes. Total tax exemption is granted to Service men and their families, invalids, men over 60 years and women above 55. In essence this is an income tax and is collected monthly. Annual income up to 1,800 roubles is taxable at the rate of 120 roubles per year, income between 9,600 and 10,800 roubles is taxed at 1,020 roubles per year, income above 24,000 roubles per year is taxed at 2,700 roubles per year or 225 roubles per month. The tax rate applied to collective farmers and individual peasant farmers ranges from 150 to 500 roubles per year. The law provides for certain exemptions. Up to 1944 the war tax gave the budget 33 thousand million roubles.

The tax on single persons, childless families and families with one and two children is payable by men between 20 and 50 years of age, and women between 20 and 45.

This tax, too, is based on the principle of the income tax. Persons with no children pay an additional 6 per cent, persons

with one child—an additional 1 per cent, and persons with two children—an additional ½ per cent of their incomes. Collective farmers pay 150, 50 and 25 roubles per year respectively.

Servicemen and their wives, invalids, or persons who have lost one or more children in the war, and women receiving State grants as mothers of large families are all exempt from the tax.

Voluntary donations by Soviet citizens are almost equal to the total tax receipts! In addition to the State loans and savings bank deposits which were widespread before the war, Soviet citizens now donate large sums to the country's Defence Fund, and these donations reflect the high patriotism and enthusiasm of the wide masses of the population.

In the first three years of the war the Government floated three loans. The first of these, floated in 1942, for 10 thousand million roubles was over-subscribed within 10 days, the total subscription reaching 12,860 million roubles.

The second war loan, issued in 1943, met with similar success. The original sum of 12 thousand million roubles was surpassed in the first week and total subscriptions reached 20,323 million roubles. This made it possible to float the 1944 war loan at 25 thousand million roubles. Within six days the loan was over-subscribed and yielded altogether 28,064 million roubles.

Thus, three war loans gave the State budget 61.2 thousand million roubles. To appraise the nature and scope of these financial operations, one must bear in mind that total subscriptions to all State loans up to the beginning of the war amounted to some 50 thousand million roubles. In addition to war loans several State-sponsored lotteries run during the war produced nearly 7 thousand million roubles.

Parallel to this wide participation of all sections of the population in State loans, there has appeared during the war another movement aimed at rendering the maximum support to the front and organising relief for the people of the liberated areas. This patriotic movement which began at the very outbreak of the war is constantly growing in scope, and as the Red Army multiplies its victories we have new manifestations of the people's concern for their army and fellow citizens.

The movement started with the establishment, on the initiative of the people themselves, of a Defence Fund. Contributions to this are made by men and women from all parts of the country, by collective farms, co-operative associations, church congregations and military units. By the spring of this year such

contributions amounted to over 14 thousand million roubles. Usually, these contributions are accompanied by messages to Marshal Stalin, or by requests that tanks, airplanes or other equipment purchased out of this money be named in honour of the organisation which donated it. Nor are monetary contributions the only form of such voluntary donations. Many valuables, much food and over 4 thousand million roubles worth of State Loan Bonds have been contributed to the fund. The contribution of State Loan Bonds helps the Government to cover its public debt and thus reduces budgetary expenditure on this item. Very often collective farms, on the initiative of their members, plant extra land, the harvest from which is donated to the Fund. In Georgia, for example, such extra planting in 1943 covered an area of 13,000 acres.

Another expression of the patriotic sentiment of the people is the constant stream of gifts sent by individuals and organisations to the army at the front. Up to 1944 the people of the Kirghiz Republic dispatched to the front 300 car-loads of gifts and over 600,000 winter garments. The people of the Kazakh Republic during the same period donated 2,000,000 winter garments, and over 1,600 car-loads of gifts. Voluntary donations by the population of the Urals area sufficed to equip an entire tank corps manned throughout by volunteers from the Urals.

Notwithstanding the fact that war expenditure accounts for over one-half of the State budget, the budget estimates for 1944 provide for substantial appropriations for cultural and welfare services. Altogether 51.4 thousand million roubles have been allocated under this head as compared to 37.2 thousand million roubles in 1943, which represents an increase of 38.2 per cent. Naturally, this increase is to a certain extent associated with war conditions, since expenditure on benefits to Service men's families, pensions, etc., has sharply increased. At the same time the wider use of female labour in the war industries made it necessary to spend more money on the organisation of kindergartens, nurseries and similar institutions. The need for more trained personnel in all branches of industry has led to increased allocations to the educational system, especially since obligatory elementary education now starts at the age of seven and not at the age of eight as was the case previously. Considerable appropriations were made for the maintenance of higher educational institutions and research centres which play no small part in the war effort.

Last, but not least, the work of procuring the material resources for the successful prosecution of the war is essentially lightened by the substantial aid of our great Allies, the United States of America and Great Britain. This aid is highly valued by the Soviet people.

Chapter Five

THE SUPERVISION OF STATE FINANCE

THE Soviet financial system is not limited merely to the State budget; though that does in itself, as pointed out above, comprise a whole system of separate budgets.

The U.S.S.R. budget includes the basic part of the country's finances.

A second part consists of bank credits controlled by the State Bank of the U.S.S.R., which is the only body issuing short-term credits, and serves as cashier for all State finance, including the budget. The State Bank of the U.S.S.R. is the sole controlling centre for short-term credits, not only by virtue of its having no competitors in this respect, but also because State-owned enterprises are not permitted to issue promissory notes to their clients. Both the buyer and seller of commodities produced by State enterprises can apply for credit, if such is necessary, only to the State Bank of the U.S.S.R. The same principle governs relations between co-operative organisations. This key position of the State Bank which is the country's cashier and controller of short-term credit, makes the bank the basic regulator of money circulation.

The third component part of the Soviet financial system is the financing of the various branches of the national economy. Each branch of the national economy consists of several independent enterprises with their own balance sheets, bank accounts, and credits in the State Bank. Economic establishments are financed out of the proceeds derived from the sale of their own produce, from State Bank credits, and from budgetary appropriations to replenish their working capital and extend capital investment. In their sum total these finances constitute a very imposing amount.

Having paid into the budget the Turnover Tax and the share of its profits fixed by the plan, a given enterprise can devote the rest of its financial resources to increasing working capital, new capital investments and the improvement of its cultural and

welfare services. The general rule in this respect is that the enterprise's own accumulated funds are the prime source from which it meets its requirements, whereas budgetary appropriations are but an auxiliary source. The State Bank issues credit only to meet seasonal requirements for more working capital.

The fourth component part of the Soviet financial system is the Social Insurance Fund. In recent years the Social Insurance Fund has been included in the general State budget, but organisationally it is controlled by the trade unions. Yet another part of the Soviet financial system lies in the various forms of State-controlled insurance.

Lastly, the financial system of the U.S.S.R. includes also the finances of co-operative societies and collective farms. Though organisationally independent, these finances are closely associated with the general financial scheme, and are taken into account in drawing up the general balance sheet of the nation's financial resources necessary for the fulfilment of its plans for economic development.

The Council of People's Commissars of the U.S.S.R. unites and directs the entire financial system; the finances of the various Union Republics are similarly directed by their Councils of People's Commissars. Administrative supervision of the financial system is exercised by the All-Union and Republican Commissariats of Finance. However, the functions of these Commissariats are limited to the budget and to the control of the activities of all the financial bodies.

The People's Commissariat of Finance of the U.S.S.R. has charge of the U.S.S.R. State Budget. In all other respects its functions are that of a supervisory and controlling body. Since the budget provides for huge capital investments in public economy, the People's Commissariat of Finance of the U.S.S.R. maintains a number of special bodies through which budgetary appropriations are passed on to the various branches of national economy and their expenditure checked.

These bodies are organised along the lines of long-term credit banks, and cater for various branches of the national economy (industry, agriculture, trade, municipal enterprise). The savings bank system is also subordinated to the People's Commissariat of Finance of the U.S.S.R.

The State Bank of the U.S.S.R. is an independent institution and its chairman is a member of the Council of People's

Commissars where he enjoys the same rights as the People's Commissar of Finance.

The finances of the individual branches of the national economy are supervised by the different People's Commissariats.

The finances of co-operative enterprises are entirely in the hands of the respective co-operative bodies, while the finances of collective farms are managed by the board of each collective farm.

There can be no doubt that the financial system of any modern State must needs have two vital characteristic features. Firstly, there is a direct relationship between finance and the distribution of the national income. Modern finance is inconceivable in isolation from considerations of distribution. Present-day war-time finance provides clear proof of the importance of the financial system in distributing the national income. Secondly, the financial system as a rule is concerned with money and is inconceivable outside the sphere of commodity and monetary relationships. That is why financial management is so closely linked up with supervision of the monetary system.

But in the case of the Soviet financial system one more characteristic feature should be noted, namely, that the Soviet finances rest not only on the distribution of the national income, but also on the production of the major part of this income. As already pointed out, the basic mass of Soviet finance comes direct from State-owned enterprises, and is drawn from their accumulated economic resources. In other countries the funds accumulated within the national economy are not concentrated in the State budget, and the latter can draw on them only through the Government credit system and taxation. Under Soviet conditions money in private hands can only function in the form of personal savings, whether deposited in State savings banks, invested in State loans, or tucked away at home.

In examining these three characteristic features of the Soviet financial system we note that the basis of financial relationships in the U.S.S.R. is entirely controlled by the State and its various bodies. This greatly facilitates the organisation of the financial system and its rational supervision.

The most vital element in supervising the financial resources of the State—the distribution of the national income—is covered by the State economic plan. This is particularly true of the basic task in the distributing of the national income, that of dividing it for production purposes and consumption.

The direct contact of the Soviet Union's financial system with its industrial organisation is based on a precise and detailed plan of production and on an equally precise plan of financial relationships between State enterprises and the budget. Production establishments work according to a plan which provides for definite quantity and quality of output, fixed production costs and marketing prices. Thus, the accumulation of reserves by economic establishments is also pre-determined by the plan, and the transfer to the State budget of part of such reserves is likewise fixed.

The monetary part of the country's financial resources is likewise subordinated to the plan, since money serves as an instrument of general economic policy and money circulation is free from accidental factors and can be influenced by the plan.

Two basic facts determine the condition and trend of money circulation in the U.S.S.R. The first of these is that the total volume of money in circulation is balanced by an equal volume of goods and services produced by State-owned enterprises and organisations. It is the task of the plan to bring the circulation of money into accord with the circulation of goods. But this task, too, is made easier because of the second factor governing money circulation in the U.S.S.R. This is the fact that prices on all goods and services are fixed according to plan.

Soviet price policy reflects all the chief economic and political tasks outlined in the plan. The policy with regard to prices is to produce a favourable relation between the development of industry and the development of agriculture. This helps to solve the political problem of the correct relationship between the interests of the two allied classes—the industrial workers and the collective farm peasantry. The price policy pre-determines the distribution of the national income and thus lightens the tasks confronting the financial system. This provides for well-founded and realistic financial programmes.

The position of Soviet currency with regard to foreign exchange is guaranteed by the country's firm foreign trade monopoly which enables the Government to maintain a favourable foreign trade balance. The accurate fulfilment by Soviet organisations of all obligations in the field of foreign trade, a favourable foreign trade balance and the growing production of gold—that source of "world money"—all go to guarantee the stability of Soviet currency in respect to foreign exchange.

The planned control of the money circulation presupposes not

only an economic policy designed to safeguard the stability of the Soviet currency. It proceeds from the desire to put the country's money at the service of the national economy as a means of achieving the objectives set by the plan. From this it follows that money circulation itself must be subjected to planning and control.

Victory over this anarchy, which has made it possible to place the country's money at the disposal of the economic plan, is due to the fact that in the overwhelming majority of cases the socialised economy is the sole source of the population's monetary income. This is particularly the case with regard to the urban population whose basic income comes from wages. But it is also true of the rural population now united in collective farms.

The existence of such socialised sources of income means that the State is in a position to plan income from these sources. Organisationally, these sources are controlled by the State Bank which is the nation's cashier and operates in accordance with a special monetary plan approved by the Government. The bank's monetary plan not only fixes the sums of wages and payments to collective farmers for products purchased from them, but also the way in which they are transferred from the centre to the outlying districts, and also the reverse process, the flow of money from the provinces to the centre. The entire cash intake of State-owned and co-operative retail trade, as well as contributions provided for by the budget are deposited in the bank. The balance of two basic movements of money—centrifugal and centripetal—is in the hands of the State which also controls the volume of commodities and prices.

Chapter Six

CONCLUSION

THE war against Nazi Germany has proved a difficult test for all the freedom-loving peoples, including the Soviet Union which has had to wage a hard-fought and bloody struggle on its own soil. But the war has also been a test for the Soviet financial system. War conditions utterly eliminated the term "impossible" from the vocabulary of Soviet finance. Work on financial problems connected with the war effort dominates all the activities of the financial system. The war has put to the test also the flexibility of this system and, as has been proved, this test has been satisfactorily passed.

Victory and peace, so desired by the peoples, are already in sight. We can also visualise the outlines of that tremendous creative effort which will be required to rehabilitate the national economy, and particularly the numerous cities, villages, industrial plants, cultural institutions, and dwelling houses destroyed by the war. This great and costly work has, in fact, already begun.

It is difficult to say whether after the war the demands on the financial system will be less or even greater than they are now. But it can be said with certainty that the financial system of the U.S.S.R. will not be confronted with any special transition problems. The war has taught the Soviet people to bend every effort to victory. It has released new reserves of energy and new fields for applying the peoples' talents and abilities. There can be no question of unemployment appearing after the war. Quite the contrary, the war has served to intensify the industrialisation of vast areas in the eastern parts of the Soviet Union. This process will continue after hostilities are over, and will be part of the general rehabilitation scheme. The war has taught Soviet engineers and workers the use of better and quicker methods in building new factories and in making use of local building materials. This, too, will become permanent. The war has taught the Soviet Union improved methods of conveyor production which will remain in industry. Finally, the war has served further to raise labour productivity.

In this brief survey we have endeavoured to show that Soviet finances rest not only, and in fact least of all, on distribution, but rather on production itself which provides the basic mass of the nation's financial resources. For that reason the rehabilitation of the national economy, like the industrialisation of the country throughout the first three Five-Year Plans, will draw its resources from the very process of rehabilitation and reconstruction.

However, there is yet another aspect of the question. The population of a great country which has borne the colossal burden of war is vitally interested in accelerating the process of rehabilitation and in reducing to a minimum the privations associated with the immediate post-war period. But this requires that the nation's resources be augmented from without.

One means of achieving this is the just utilisation of the resources of Russia's defeated foes who have caused her—deliberately, wantonly and systematically—such tremendous damage and suffering. We must present to defeated Germany, its satellites and accomplices in crime, a full and substantiated bill for war damages. We must not forgive the cruel enemy even a single destroyed cottage, nor a single building, nor a single factory, mine, or power plant. The Nazi criminals must pay, and pay they will in full. Germany, according to her ill-starred Fuehrer, spent over 90 thousand million marks over a period of five or six years in preparation for this war. At present she is spending hundreds of millions of marks for war purposes. This proves that Germany can pay for the damage caused to Russia.

But it is not only Russia who has suffered from Nazi attack. Devastated areas stretch far and wide and this fact will undoubtedly delay economic development throughout the entire world.

Therefore, the rehabilitation, in the shortest possible space of time, of all countries ruined by the war is in the common interest of all nations. The continuation after the war of the fighting alliance in the form of close collaboration of the United Nations in rebuilding Europe's economy will be one of the most important conditions making for a rapid elimination of the terrible consequences of the war and for the organisation of peaceful construction in the interest of all freedom-loving peoples.


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