

The Role of Accounting in a Planned Economy

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INTRODUCTION

The basic problem facing any economy is that of determining the allocation of the scarce resources so that they will go as far as possible towards satisfying society's ever increasing wants or needs. The allocational tasks might be simpler in a primitive society where the needs are limited, the means available are scanty, and the range of choices is narrow and less complicated. However, as an economy progresses and becomes more advanced, concern with scarcity relations deepens and the need for a system of economic information becomes eminent in order to make any proper decisions concerning the allocation of resources. This is where the function of accounting could be appreciated.

Accounting is broadly defined as a process of measurement and communication of economic information needed for the proper allocation of society's resources and the efficient conduct of its economic activities. As a measurement process, accounting attempts to assign quantitative measures to economic properties and events. It is the concept of value that accounting actually attempts to quantify. Value does not need to be measured when it is dealt with only as a theoretical concept. But when dealing with this concept in terms of production and distribution of goods and services, the quantification process becomes necessary.

The use of prices represents one method of quantifying value. In a free market economy, prices are determined by the functioning of the market mechanism directed by the forces of demand and supply. The automatic price mechanism of a free economy acts as the conductor of economic activities and is entrusted to bring about equilibrium and har-

mony between supply and demand; between production and consumption. This mechanism, presumably, leads to the efficient allocation of resources in a capitalist economy.

Prices as determined by a free market mechanism are available for the accountant to use in his calculations. In other words, they provide accounting with some basis of value measurement.

However, in a planned economy such as of the socialist countries, the automatic price mechanism does not exist. Prices are determined by the state and not by the forces of supply and demand. Production decisions are made according to a plan drawn by a central planning authority. Therefore, accounting under this type of economy would have to assume a different role since there is no market mechanism to help the accountant in the process of measurement and assigning quantifiable value to economic properties and events.

It is the aim of this paper to examine the role of accounting in a planned economy, throw some light on the objectives of accounting and the problems of their implementation in such a system. Emphasis will be placed on the role of accounting in pricing. Some examples of the Soviet practices are presented.

PLANNED ECONOMY

By "planned economy", it is meant an economy where the activities of production and distribution of goods and services in the country are conducted according to a plan set by the central authority or government, with the aim of achieving the most rational utilization of the society's resources. This concept implies a command economy in which the pattern of production is regulated, not by the market mechanism, but by the direction and command of a central planning authority.

This type of economy is exemplified by the

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system prevailing in the Soviet Union as well as the other Socialist countries. To better understand how a planned economy operates, it is perhaps worth-while to briefly review the planning process as it exists in the Soviet Union.

THE SOVIET PLANNING

At the head of the Soviet planning machinery, there is the Central Planning Commission (Gosplan). Then, there is a planning commission in each of the sixteen Soviet Republics. Each Republic is further divided into regions and each region is equipped with a planning commission of its own. Below that, there are the districts in every region with their planning machinery. Then there is a planning organization in each town or village in the district. But the lowest planning unit is the factory or the farm. In addition to this geographical organization, there is also a functional organization of the planning agencies. Each ministry has a planning unit, which, in turn, supervises the planning sections attached to enterprises under its jurisdiction.¹ Planning in the Soviet Union rests on an elaborate and comprehensive statistical base. Statistical materials are provided by the "Central Statistical Administration" and its republic and regional counterparts who gather data continually from the organs of the appropriate economic ministries".² The process of planning starts with the Central Planning Commission formulating a draft plan in consultation with the various ministers. Targets for each ministry are worked out individually and then submitted to the Central Planning Commission in order to be examined and coordinated into a single comprehensive plan.³

Side by side, with this planning at the top, the process of Soviet planning also starts at the bottom. Each factory and each collective farm and each state farm prepares its own

perspective plan on the basis of its past experience and future technical possibilities. These plans of individual enterprises and farms come up through both functional and geographical channels to the Central Planning Commission. There is then a balancing of the draft plans — one from the top and one from the bottom. Necessary changes can be made and the final plan can be prepared and submitted to the supreme Soviet authorities for approval. As soon as the plan is approved, it acquires the force of law and it becomes binding.

Plans are usually long term (five-years period). But a long term plan is usually divided into concrete plans of one-year and less.

The over-all plan is broken down to plans for individual enterprises or industries. An enterprise is legally bound to fulfill all plans approved for it by the State. These plans are developed first in terms of physical terms and are called "production plans". Later, the production plans are restated in terms of monetary units and thereby become financial plans.⁴

To insure the coherence and compatibility of the various production schedules, the Soviets use a system called material balances.⁵ This system attempts to strike equations between the various magnitudes of the plan so as to keep it internally consistent in order to prevent disproportions in the various sectors of the economy. In each commodity to be produced, an attempt is made to estimate the total demand of such commodity and the total supply is to be planned on these basis. The total demand and the total supply available during the planning period must balance each other. In this way, balances have to be made for innumerable commodities and services to keep the plan coherent.

An economy which is based on such a process, where the important decisions of production and distribution for all sectors of the economy have to be made at the top, will need accurate and sufficient information.

1. Mikhail Bor, *Aims and Methods of Soviet Planning*, (New York: United Publishers, 1967), pp. 62-63.
2. Richard B. Purdue, "Techniques of Soviet Accounting", *The Journal of Accountancy*, (July, 1959), p. 47.
3. M. L. Seth, *Theory and Practice of Economic Planning*, (Delhi: S. Chand & Co., 1967), pp. 62-63.

4. E. Joe De Maris, "Problems of the Russian Accountant", *The Journal of Accountancy* (July, 1959), p. 52.
5. Abram Burgson, *The Economics of Soviet Planning*, (New Haven: Yale University Press, 1964), p. 138.

Accounting, as a process of measuring and communicating economic information, plays an important role in this system.

ROLE OF ACCOUNTING

Richard B. Purdue points out the following:

The Soviet Union has not succeeded in establishing an accounting system different in kind from that of the West. In the face of the practical problems of recording economic transaction the Soviet Union has been forced to adapt procedures distinguishable from those of capitalist countries only by their uniformity, and by the artificial determination by the state of accounting data which in the West are determined by free competition.⁶

Accounting reports in the Soviet Union are designed to provide basis information of production cost and quantity, and sales disposition. These can be summarized by the proper ministries and submitted to the Central Statistical Administration, which, in turn, summarizes and analyzes it for purposes of the Central Planning Commission and other economic organs.⁷ Accounting reports by individual enterprises are standardized. The purpose of such standardization is to better facilitate centralized control and planning. The reports are used in the evaluation of the administrative organization and enterprise efficiency, and the efficiency of the allocation process. The reports are also an integral tool in developing the plans.

The other distinctive feature of Soviet accounting, and the most important one for the sake of this paper, is that its system of prices and costs is almost wholly determined by accounting alone without any help from the market process.⁸ Prices in a capitalist economy are determined in the market place by supply and demand. These market prices are available for the accountant to use in his measurement and communication process. But, in a planned economy, as in the Soviet Union, there is no market mechanism as such to determine prices. It is the accountant's

function to determine prices and put value on goods produced. This function of accounting is an essential one since basis production and distribution decisions are based on accounting information. This seems to make some writers believe that accounting is even more essential to a planned economy than to a free economy.⁹ Their reasoning is found in the fact that, in a capitalist economy, decisions of production and consumption are automatically made in the market and determined by the market price. Accounting calculation comes after this process is completed in order to measure the efficiency. But in a planned economy, the accounting function comes before decisions are made. The availability of accounting prices is necessary before any proper production decisions can be made in a planned economy.

One of the basic criteria used in determining prices is the cost of production. Cost of production in the Soviet Union means the cost data provided by the accounting operation of Soviet enterprises. This leads to the discussion of the Soviet methods of costing.

COSTING IN THE SOVIET ENTERPRISE

The planning of prices in the Soviet Union is directly connected with the planning of costs. The money cost of production in a particular enterprise is determined in the following manner. The cost is expressed first in real terms. Various factors of input that go into each unit of production are estimated and translated into money terms. This money cost is termed a "planned cost". A certain percentage of profit is then added to the planned cost in order to determine the wholesale price in which the output is to be transferred to distributive stores or other entities.¹⁰

Emphasis in the Soviet accounting is placed on the unit cost of production. The unit cost of production has been cited as "probably the most emphasized indicator of success or failure of an enterprise in the

6. Richard B. Purdue, *op. cit.*, p. 51.

7. *Ibid.*, p. 48.

8. Robert Campbell, *Accounting in Soviet Planning and Management*, (Cambridge, Mass.: Harvard University Press, 1963), p. 16.

9. T.J. B. Hoff, *Economic Calculation in the Socialist Economy* (London: William Hodge & Co., Limited, 1949), p. 230.

10. M. L. Seth, *op. cit.*, p. 49.

U.S.R.R.”.¹¹ Professor Campbell has summarized the main weaknesses of the Soviet cost accounting system in the following: (1) Cost of capital consumption (depreciation) is poorly estimated; (2) current expenditures are not properly allocated among individual kinds of product; (4) the use of broad aggregate accounts results in poor tracing of expenses through the plant; and (5) cost of individual products or of separate process are often not ascertainable.

Depreciation. Depreciation charges in the Soviet Union consist of two parts: “one is the amortization of original asset cost and the other is an allocation for estimated major repair costs”.¹³ These major repairs are called capital repairs and are estimated over the life of the assets. Depreciation rates in Russia are calculated on a straight-line basis. But inclusion of the capital repair in the depreciation charge seems to complicate the calculation and may result in over or under depreciating of assets. Besides, these capital repairs do not extend the life of the assets or increase their productivity over what is anticipated at the time of acquisition.

THE CONTROL FUNCTION OF ACCOUNTING

One of the important functions of accounting is to provide information for control purposes. This function has different tasks to accomplish in a planned economy from those in a market economy. In a market system, the foremost purpose of control is to measure the efficiency of factors of production employed within a firm. In a planned economy, such as in the Soviet Union, the problem of paramount importance is the accountability to and the control of the firm by the supervisory units.

Plan fulfillment is considered the most important objective on the basis of which performance is evaluated. Planning cannot be completed unless it takes into account the cause of

the fulfillment of the planned targets. But using the plan itself as the criterion for evaluating an enterprises’ performance has some obvious drawbacks. Directors and managers of the enterprise will generally seek to have low target goals which are easy to achieve since their performance is measured by the achievement of these planned goals.¹⁴ This will make firm managers reluctant to introduce new technology and to improve quality standards.

Another problem arises from the fact that top level authorities in the Soviet Union are interested in fulfillment of annual plans in physical terms, whereas the planned profit is expressed in money terms. Managers are often squeezed by this situation. They attempt to close the gap by such solutions as improper cost allocations and the like.

Supervision of the plans call for an independent body of experts and technical accountants unconnected either with plan formulation or plan execution. This body should evaluate plan fulfillment and enterprise performance in a strictly impartial manner.

CONCLUSION

The problem in a planned economy is that its pricing process, being artificial and arbitrary in character, might lead to the wasteful allocation of productive factors because it will not be possible to reckon precisely where its employment shall yield the maximum returns. The main issue at this point is whether not accounting is able to develop an adequate technique for pricing in a planned economy. The importance of accounting in a socialist economy is stressed by the fact that any fallacy in concept or inaccuracy in practice has far-reaching repercussions since there is no market mechanism to correct them.

The development of an adequate pricing system for a planned economy depends on progress in measuring costs. The progress that has already been made in developing adequate systems of costing in big capitalist corporations gives a hope that an efficient pricing technique based on costs may be achieved. This, of course, will depend on the progress in research that is badly needed in this particular area.

11. Richard B. Purdue, *op. cit.*, p. 49.

12. Robert Campbell, “Soviet Accounting and Economic Decision”, *Value and Plan*, ed. G. Grossman, pp. 77-78.

13. Robert H. Mills and Abbott L. Brown, “Soviet Economic Developments and Accounting”, *The Journal of Accountancy*, (June, 1966), p. 41.

14. *Ibid.*, p. 40.