

THE SOVIET STATE BUDGET

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Introduction

The growing role of government in developing countries, whether they are following a socialistic or capitalistic path, raises the interesting question of how government intervention is to ensure higher rates of growth and healthy economic development. We already have many treasuries of experience in developing countries, most of which have been reached through trial and error. The Soviet example is an interesting one which is worthy of study¹. The increasing statistics released by the U.S.S.R. reveals the excellent performance of the Soviet system. High rates of growth have been achieved since the early fifties. This fact attracted the attention of economists as to how the economic system works. It was readily indicated that fiscal tools were the essence of control. This exposition and analysis of the Soviet state budget is hoped to be a case study of economic control through the budget. The experience of the Soviet control mechanism may prove to be irrelevant as a whole to many countries striving for economic development, but to many it is an alternative way of looking at things. In Libya it has special significance because fiscal measures have not been used as a major method of controlling the economy. Thus, it will be useful to study the Soviet system as just one of the many alternative techniques of using fiscal controls.

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1. My interest in the Soviet economy originally started in the period 1959 - 1961 during post-graduate work at the University of Minnesota. Recently this interest was furthered by an invitation from the Soviet Academy of Science to visit the U.S.S.R. For three weeks in the summer of 1966, I had interesting discussions concerning a wide range of topics with Soviet economists in Moscow, Leningrad, Tashkent and Tbilisi. I would like to thank them all for their courtesy and help, especially the economists of The Institute for Economic Planning and The Institute for Mathematical Economic Planning. I would also like to thank my colleague, W. Wedley, who read the rough draft and helped improve the style.

Having this in mind, the ideological contents and premises of the Soviet system are not emphasized throughout this paper.

While this paper is an attempt to examine the Soviet state budget, it is particularly interested in the mechanism of the whole system as reflected in the budget. Although there exist other budgets in the Soviet Union besides the state budget, this paper will not deal with any of them.

In Part I a general view of the development of the state budget is given. Then Part II will deal with the state budget, tracing the various revenues and expenditures. Part III will be a theoretical discussion of the functions of the Soviet budget.

I The Development of the Soviet State Budget.

The Soviet budgetary system did not emerge as a central instrument in the hands of the state until the first five year plan in 1928. However, the inflationary expenditures of the government after the revolution in 1917 subsequently gave the budget a significant role in the state measures to cope with inflation. The state, through increasing the rates of existing taxes and imposing new taxes, tried to reduce the currency in circulation. Then came the nationalization drive of 1918 to add to the dominant part played by the budget. The increased public sector of the economy seemed after 1918 to destroy economic activities and eventually would have led to a collapse of the economic system.

The economic crisis of 1920-21 and the decline of the monetary economy were reflected in the budget. Revenues fell short of balancing the budget, production dipped below the pre-revolution levels, and foreign sources of economic aid were absent. The new government first tried a budget in kind and tried to eliminate money from the system. The unsuccessful attempts of a non-monetary economy were ended when the New Economic Policy (NEP) was adopted after 1921.

During the mixed economy from 1921 to 1928, the role of the budget was an ordinary one. The NEP did not by and large depart from the original attitude toward the nationalized sector of the economy. But

the state owned industry under NEP was financially independent of the budget and organized by a system first known as 'economic accounting' and later, as 'commercial accounting' "... which may roughly be translated as meaning that economic units had to finance their own production out of sales, on cost accounting principles."²

The most important development concerning the role of the Soviet budget came in 1928 with the first five year plan. The bulk of the marketed agricultural produce was incorporated into the socially owned sectors as a result of mass collectivization, and the small sector of privately owned trade and industry was almost entirely absorbed by the state and cooperative sectors. This mass socialization of the economy was a major turning point in the development of the Soviet fiscal policy.

Under the planned economy, the state controlled directly or indirectly every economic activity. Industry became completely state owned, and agriculture was either operated under direct control as in the state farms or indirectly controlled through compulsory deliveries and fixed prices.

The increase of productivity and the improvement of economic conditions under the state controlled economy brought into debate the question of the "moneyless" system. The attempt of abolishing money was finally defeated, and the USSR remained basically a monetary economy for the following reasons :³

1) Money was required to maintain differing levels of income within the population and to give the consumer a market choice within the available supply.

2) Money was needed to facilitate the state-collective farms' relationship through compulsory delivery at fixed prices. The compulsory delivery was planned to secure farm products for the growing industrial sector and to impose a heavy tax on the collective farms' peasants in the form of low prices.

2. R. W. Davies, *Development of the Soviet Budgetary System*, (Cambridge, 1958), p. 71.

3. Davies :

3) Money was needed to provide a framework for current costing within industry and a measure of efficiency in terms of a common financial unit. What has become known as "control by the ruble" emerged from the money wage system used in economic organizations.

The Soviet financial planning system is based on certain principles which we can briefly state in the following :

1) Planning is in physical terms and direct allocation of resources is basic. Prices are not determining but rather determined.

2) A monetary economy is, however, needed for the payment of wages for retail distribution, for relations with the non-state sector, and for costing of current production in the state sector.

3) Accumulation is made out of current income. It must come from taxes, the internal profits of industry, or from inflationary spending; it cannot come from personal saving to any appreciable extent.⁴

With the intensification of planning and state control over the economy, the budget became more prominent in the Soviet financial system. Under the unified financial plan in the mid-thirties, the state budget was expanded to include the social insurance system, but bank credit and currency issue plans were kept administratively separate.

Using the budget as a main source of accumulation has been proved to be very vital to the investment policy of the Soviet Union. For capital investment programs, there are two main sources of accumulation: the budget and the retained profits of enterprises. The turnover tax has been the mainspring of the budget revenue. Next to the turnover tax deductions from profits has been a very important source of the budget revenue and lately this revenue has been increasing rapidly. Other revenue items yielded between one-third to one-half of the budget.

The first and second five year plans brought to the scene an acute inflationary problem. The inflationary gap was primarily a wage inflation. From 1928 to 1940 the average wage increased almost sixfold and the annual pay roll about fifteenfold.⁵ This phenomenal increase in wages is shown in Table I.

4. Davies, p. 147.

5. E. D. Holzman, *Soviet Taxation*, (Harvard : 1955), p. 38.

TABLE I
Average Annual Wage Rate Planned and Realized, 1928-1942.

Year	Wage Rate (rubles)		Increase per cent		Total
	Planned	Realized	Planned	Unplanned	
1928	690	703	—	2	—
1929	—	800	—	—	14
1930	—	936	—	—	17
1931	941	1127	7.1	20	20
1932	994	1937	—	—	27
1933	1523	1566	6.7	3	10
1934	1625	1858	3.8	14	19
1935	2031	2269	9.3	12	22
1936	2465	2856	8.6	16	26
1937	2978	3038	4.3	2	6
1938	—	3467	4.3	2	6
1939	—	3867	—	—	14
1940	—	4069	—	—	11
1942	4100	—	—	—	—

Source : Holzman, p. 39.

Note : Figures are in the old ruble rate.

The phenomenon of rising wage rates reflected the failure of the financial system to maintain the planned monetary equilibrium. The easy credit policy given to the directors of enterprises was used in bidding for skilled workers and consequently resulted in higher realized wage rates than those planned by the state. To cope with this cost-push inflation, the Soviet central authorities took the following steps :

1) The first step was a new experiment in using the state bank control over the wage funds. It was first introduced in 1938 and was applied to certain big enterprises. By 1939, the state bank control extended to all economic organization. The features of this system were :

a) basically the wage fund control was tied to the fulfillment of the plan of gross output. Overexpenditure for wages was allowed only if the output plan was overfulfilled.

b) the bank must automatically provide funds for a relative over-expenditure of up to ten per cent in the first month only.

c) the bank was not authorized to disburse funds to an enterprise which repeatedly overspent its wage allotment unless the enterprise secures permission from its central administration or trust.

d) overexpenditure in any month amounting to more than ten per cent whether primary or repeated requires permission of the Ministry, and funds must be redistributed from the wage funds of other enterprises in the Ministry.

2) The second step to cope with inflation was modification of the revenue system. Direct taxes rose in 1940 to a maximum rate of 13 per cent on earnings above 1000 rubles per month. Discriminatory rates were imposed on individuals in the private sector to increase the revenue and to drive them to the socialized sector. State bonds were sold under social pressure to encourage saving from the household, thus reducing the demand and bridging the inflationary gap. These measures together with increased state control because of the war helped in checking the inflation, or rather suppressing it, throughout the war period.

The state budget emerged from the war period as an even stronger central instrument in the Soviet fiscal system. The monetary reform of 1947, the war experience, and the budget adjustment to the peace economy proved to be a significant factor in the great economic expansion of the fifties and early sixties.

The budget system has not changed in the post war era and seems as if it is not going to undergo any drastic change in the coming decade, though the decentralization which is gaining in prominence may yet influence the budget as an effective instrument of control. However, the author's discussion with Soviet economists revealed the confusion among them in what would be the results of decentralizing the Soviet economy. More will be given on this point later.

II The Soviet State Budget.

The concept of the Soviet state budget went undefined throughout the Soviet rule until 1959. Resolov, the finance minister, gave the first

systematic definition of the budget in his report to the Supreme Soviet in 1959. He defined the budget as "... the basic financial plan for the formation and use of the Soviet state monetary resources."⁶ This definition is merely a confirmation of the budget concept as it has been used in practice since the planning era started in the late twenties. However, the budget does reflect the economic plan. It sets forth the distribution of material resources of the nation necessary for the fulfillment of the planned economic objectives.

Although the state budget is responsible for the large financial operations, we should note that it is not the only set of financial accounts. For complete monetary stability, it is necessary to dovetail the budget with credit and cash plans. Operations outside the scope of the state budget include (1) the plan for investment out of retained profits by individual enterprises, cooperatives, and collective farms; (2) the fund for amortization; and (3) the balance of income and expenditure of the population. The state budget is a net figure and includes only (1) tax payment (2) receipt of subsidies (both these two items comprising the national enterprises), and (3) tax payment by the population. The normal operating receipts and expenditures of all the national organizations remain outside the state budget.

In spite of the fact that the state budget is a net figure, still it is a large budget. This is so, because of the important functions assigned to the budget in the Soviet system. The following are the functions given to the state budget :

- 1) On the expenditure side, through the budget, the state diverts income from the household to finance investment and to reduce demand in the market so as to suppress a demand-pull type of inflation. The investment item as it appears in the budget includes net investment in both fixed and working capital.

- 2) Defense, which became very important since 1936 through the war and the cold war that the Soviets are engaged in.

6. See, *Current Digest of Soviet Press*, December, 1959.

- 3) The increasing administration expenses of the country.
- 4) Increasing social and cultural measures financed by the state budget.

Structure of the Budget.

The Soviet state budget is a consolidated budget; it is a coordinating budget and not an operating one. The state budget is comprised of :

- 1) Union budget.
 - 2) Federated republic budgets.
 - 3) Autonomous republics and local government budgets.
- The decree of 1959⁷ gives the following procedures for the state budget.

The drafts of union-republic state budgets compiled by the republic councils of ministers are a first step. These drafts together with the state social insurance budget are drawn up by the Central Council of Trade Unions and are submitted to the USSR Council of Ministers. They are examined by the USSR Ministry of Finance, with the participation of the representatives of the Union republics and the Central Council of the Trade Unions. The Ministry of Finance draws up the draft of the union budget and the draft of the state budget and submits them both to the USSR Council of Ministers together with conclusions on the drafts of the union republic budgets and the draft of the state social insurance budget.

The USSR Council of Ministers then examines the draft of the state budget and submits it to the USSR supreme Soviet for approval. The approval of the state budget includes consequently the fixation of the receipts and expenditures of all budgets included in the state budget. Below that, the political subdivision's discussion of their budgets is a formality as far as the total receipts and expenditures are concerned. The allocation of some expenditure could be changed within the general

7. See C.D.S.P., December, 1959.

plan. Viewing this procedure critically, one point is very clear, and that is the tight control of the central authority of the USSR Council of Ministers. Incidentally, going through the Supreme Soviet discussion of the budget the author did not meet any incident where the budget was altered or re-allocated.

Budget Revenue.

The socialist economy has been the main source of the budget revenue. As a matter of fact, the socialist economy accounted for 85 per cent of the budget revenue in 1956,⁸ and 92 per cent in 1966.

The revenues from the socialist economy are collected in the form of a turnover tax, deductions from profits, and income tax on collective farms. The concept of profit in the Soviet Union is the surplus over the costs of production. The state by setting the prices and determining the amount to be produced can control the profit to be realized. Enterprises can affect the amount of the profit only through cost minimization and over-fulfillment of the plan.

The state through price fixation and physical control over resource allocation directed the bulk of the capital investment to producers' goods in general and heavy industry in particular. The result has been as follows :

1) Consumer prices have been set high upon costs of production and this is a hidden tax on the consumer goods industry.

2) Producers' goods prices have been set either about or below costs of production, thus giving the industry a hidden subsidy.

3) Compulsory delivery of farm products have been at low prices and resold at high prices, thus being an extra tax on farm products. Through these devices capital accumulation is diverted to the producers' goods industry.

Table II on the next page shows the state budget revenues for 1960 through 1966. The budget revenues as it is given depends exclusively

8. See the budget report **C.D.S.P.**, January, 1956.

TABLE II
Budget Revenues (Billion Rubles)

	1960	1961	1962	1963	1964	1965	1966
I Socialist Economy	68.2	72.0	76.7	81.4	87.0	91.8	96.6
a. turnover tax	31.3	32.4	32.9	34.5	36.7	39.2	39.5
b. deductions from profits	19.0	20.5	23.9	25.7	28.7	31.6	35.2
c. tax from farms, social insurance and trade	17.9	19.1	19.9	21.2	21.6	21.0	21.9
II Taxes from population	7.4	6.9	6.0	6.3	6.8	7.3	8.1

Note : The figures given in Table II are expressed in the new ruble value as of 1 to 10 of the old ruble. (See C.D.S.P., June 1960).

on the socialist economy. The taxes levied on the population are decreasing and will be abolished as Mr. Khrushchev promised. However, taxes on population accounted for 8.1 billion rubles in the planned budget of 1966. It seems that the persistence of taxes levied on earned incomes of the Soviet citizens reveals the importance of these taxes to control the purchasing power, as the control over wages seemed ineffective.

Two main revenue items of the socialist economy are turnover tax and deductions from enterprises' profits. The increasing revenue from the socialist economy was explained by Khrushchev in the following statement. "The income accruing to our budget from the state enterprises profits and turnover tax, has its source in continually expanding production, increased labor productivity, the reduction of output costs, and the augmentation of accumulation within the economic enterprises."⁹

1. Turnover tax.

Commodity taxation normally accounted for more than 50 per cent of the total budget revenue. Due to increases in profit deduction, how-

9. C.D.S.P., June, 1960.

ever, the turnover tax began to account for only about 40 per cent of the budget revenue in the late fifties. This has continued until the present.

Indirect taxation is usually regressive, hence socially inequitable. The Soviet Union has used the turnover tax for revenue collection, disregarding the ideological conflict the turnover tax creates as to the Marxist theme of social equity. Why are the Soviets insisting on using the turnover tax?

To answer this question, we have to examine the alternative possible tax system available to the Soviets. Naturally one can think of a progressive income tax as an alternative, but there are so many disadvantages of an income tax for the Soviet Union. Firstly, turnover tax is designed to suppress the consumer sovereignty in the market and to adjust the patterns of demand to the limited supply. Moreover, the free choice in the market left by the planners could be maintained only through indirect taxes and high prices over costs of production – so as to adjust the disposable income of the household to the planned supply schedule. Secondly, through the turnover tax, the Soviets achieved high rates of what might be called forced saving to finance the industrial program. Another important factor in this respect, is administrative in nature. Levying taxes on limited numbers of enterprises is much easier than collecting taxes from individuals of a huge population scattered all over the country, and, by far, more economical. Thirdly is the important question of incentive. There is an element of “money illusion” in indirect taxes. To the ordinary citizen indirect taxes are not seen and he is interested only in his money income. Thus wage differential has been used to improve labor productivity. A progressive income tax would have impaired this incentive system.

Turnover tax is based on sales of state enterprises and other organizations, and levied either (1) as a percentage of the commodity price or (2) as an absolute sum per unit sold.

There is a range of turnover tax rates for different commodities between 1 to 99 per cent of the price of the commodity sold to the final consumer.

2. Profit tax.

The profit tax, as we have defined profit before, is second in magnitude to the turnover tax. From an administrative point of view profit tax is a supplement to the turnover tax. The profit tax as a source of revenue has been increasing because of the declining costs of production. Table III gives the yield of profit tax as compared to that of turnover tax in the last ten years.

TABLE III
Profit Tax Yield (1957-1966)
Billion Rubles

Year	Profit Tax	Turnover Tax
1957	11.6	27.6
1958	13.0	30.0
1959	15.5	33.3
1960	20.3	31.7
1961	20.5	32.4
1962	23.9	32.9
1963	25.7	34.5
1964	28.7	36.7
1965	31.6*	39.2*
1966	35.2*	39.5*

Note : The figures given are expressed in the new ruble value as of 1 to 10 of the old ruble (See **C.D.S.P.**, June 1960).

* Planned and not actual. Source : **C.D.S.P.** (1957-1966).

The difference in costs of production incurred by different enterprises gives certain enterprises better profit rates than others. This is so because the prices of the product are given by the state. The profit tax is planned to level out this profit differential.

3. Taxes in kind.

Tax in kind takes the form of compulsory deliveries to the state at low prices. It comprises a substantial part of net output of the agricultural sector. The difference between the low prices of buying and the high prices of selling by the state enters the budget as a part of the commodity tax structure. However, this tax is not a pure commodity tax, but rather an agricultural production tax, or for that matter, a rent since rent is not charged for the use of land. The major part of this tax is shifted backward to the agricultural producers. Recently, compulsory deliveries have been abolished, but the state buying prices are still very low.

4. Direct taxation.

Direct taxes have never been of any importance in the Soviet revenue system. Early in the drive for socialization, direct taxes were used to wipe out Kulaks, petty private enterprises, and the renters. Differential direct tax rates on personal income favoured the workers and artists, and since the schedule of taxation is progressive, favours the poorer against the richer¹⁰. However the progression is not as high as in western societies. The contribution of direct taxes to the budget revenues is very slender and expected to fall substantially after the abolition of the taxes on workers.

5. Agricultural tax.

Agricultural income tax is levied on both collective farmers and private farmers. By private farmers are meant members of collective farms who may also have small plots of land on which to produce products for themselves. The collective farms' gross income is subject to a separate tax, so that the collective farmer's income earned while working on the collective farm is exempted. However a farmer's personal income

10. Holzman. *National Tax Journal* (September, 1953).

from other sources is taxed at progressive rates. It starts at 8 per cent from all taxable income under 200 rubles annually and climbs in rather even steps to the maximum rate of 48 per cent on income over 800 rubles. Thus farmers pay a higher rate of tax on their private income than on their collective farm income. The differential tax rates between private and collective incomes are designed to encourage farmers to undertake more work on the collective farms than on their private plots.

6. Other receipts.

1) Public borrowing. State loans are the main item in this category. About 75 per cent of the government bonds are sold to the public. Besides the social pressures applied to sell the government bonds, lotteries with attractive prizes are given to attract certain groups of the population to buy bonds. The interest rates paid on government bonds as well as the prices are exempted from taxation.

2) Custom receipt is another item in this category. It usually covers about 2 per cent of the budget. Soviet tariffs no longer serve any of the economic functions usually associated with tariffs primarily because of the state control over export-import activities.

3) Other sources are, (a) fines, (b) licenses, (c) fees and (d) tax on inheritance.

Budget Expenditure.

The Soviet state budget is directed to four categories to finance :

- 1) the national economy.
- 2) defense.
- 3) social and cultural measures.
- 4) state administration.

1. The National Economy.

Except for World War II expenses, expenditures on financing the national economy have been the largest item in the budget, constituting about 40 per cent in 1966. The national economy includes the following major items :

- 1) industry.
- 2) agriculture.
- 3) transportation.
- 4) construction.
- 5) internal and external trade.
- 6) procurement.

An alternative approach is to classify the budget expenditures on the national economy by use. This includes the financing of :

- 1) fixed capital.
- 2) working capital.
- 3) subsidies to keep prices below costs of production in producers' goods industry.
- 4) training and scientific research.
- 5) enterprises and other national organizations.

This last item has been substantially reduced after the abolishment of the machine tractor stations in 1958. In addition to the budget expenditures there exist other means of financing the national economy. Bank credits, retained profits and amortization funds are other sources of finance which are outside the budget.

2. National Defense.

The national defense expenditure declined in the post-war period. During the fifties defense expenditure held steady as shown in Table IV.

The only rise in defense expenditure was for 1952-1953, presumably because of the Korean War and its aftermath. As to the future of the defense expenditure, this is completely unpredictable and depends on east-west relations. But given no major hostilities, one can conclude from the general trend in recent years that the defense expenditure will decline. The slight increase in the planned expenditure for 1966 over 1965 reflects the tension created by the Vietnam war. Also, the rising Chinese hostilities toward the Soviet government may tend to reverse the slowing down of the Soviet defense expenditure.

TABLE IV

National Defense Expenditure
(1957 - 1966) Billion Rubles

Year	Total
1957	9.7
1958	9.6
1959	9.6
1960	9.6
1961	12.6
1962	13.9
1963	13.3
1964	13.3
1965	12.8
1966	13.4

Source : C.D.S.P. (1957-1966).

Note : The figures given are expressed in the new ruble value as of 1 to 10 of the old ruble. (See C.D.S.P., June 1960).

3. Cultural and Social Measures.

Three items included in this ever increasing department of the budget expenditures are education, public health and social security. Table V shows the distribution of expenditure among the components of the social and cultural measures :

TABLE V

Social and Cultural Expenditure (1957-1966) Billion Rubles

Year	Total	Education	Health	Social Welfare
1957	18.8	7.9	3.8	7.1
1958	21.2	8.4	4.0	8.8
1959	23.2	9.4	4.4	9.4
1960	24.7	10.2	4.8	9.8
1962	28.9	8.6	4.9	11.6
1963	31.0	12.4	5.3	12.0
1964	33.3	15.1	5.6	12.6
1965	37.5	17.1	6.5	13.8
1966	40.3	18.7	7.1	14.6

Source : C.D.S.P. (1957-1966).

Note : The figures given are expressed in the new ruble value as of 1 to 10 of the old ruble. (See C.D.S.P., June 1960).

Again here the budget is not the only source of financing social and cultural activities. Other sources are (1) bank credit, (2) labor unions and cooperative funds, (3) director's funds, (4) collective farms' welfare funds.

4. State administration.

State expenditure on administration includes (1) expenditure on the organs of Union, republics, and local governments, (2) ministries and other units which direct various industries and other branches of the national economy, (3) administration of social and educational programs, and (4) administration of justice and internal security.

About 70 per cent of the expenditure on this item goes for salaries and wage payments. Lately expenditures on administration have been about 1.1 billion rubles, without any significant change. Other expenditure items are loan services, interest payment, and the retirement of debit.

III Objectives of the Budget.

What are the budget objectives within the framework of the Soviet system? The answer to this question is planned to be discussed in this part of the paper. The difficulty encountered in attempting to find the objectives of the Soviet budget stems from the fact that there are no definite objectives of the Soviet system. With every leader in the Soviet Union, there arise slogans and with time they disappear. The latest of these slogans is "emerging from socialism to communism". The author tried to discuss the contents of this slogan with the Soviet economists he met. What would be the effect of this change on the functions of the economic system of the Soviet Union? How is this change going to take place? And, what would be the result of this change? To the Soviets, communism is the ultimate goal of the system and they are ready to shift to this new phase of marxism. As the author has been told there will be no direct change in the system as a whole. What was meant by changing over to communism is introducing to the Soviet citizen abundant and better supplies of consumer goods. They intend to move into a stage of "mass consumption" in Rostow's terminology. More and better consumer goods, higher incomes and expanded expenditure on social welfare are the pillars of the new Soviet phase which they call communism. The stress on heavy industries, capital formations and suppression of consumer goods production are no longer the objectives of the Soviet economy in this coming stage. Taking the contents of this new slogan for granted, what would be the implication of this new policy for the function of the economic system in general and for the Soviet state budget in particular? As we have seen, the tight control over the economy through the state budget has made it possible to direct the resources of the country to achieve higher production rates in certain sectors of the

economy, primarily producer goods. Could the budget be used to achieve the objectives of the new phase of the Soviet economic development? Assuming that tight control over the economy will continue, the Soviet state budget could be used to serve the new phase. The expansion of social welfare expenditure has already been serving this purpose. Socialist economy expenditure could be directed toward consumer goods by cutting the tax burden to increase the population's earned money income or by lowering prices. The problems of the application of what is theoretically envisaged remains to be seen.

However, the economic system is not consumer oriented by any means. Consumer goods are increasing in the market, but they are still below the economic capacity that the system can offer to the Soviet citizen. Transforming the system to communism, however, requires necessarily higher rates of growth and stable economic conditions. Resource allocation, income distribution, and stability and growth are the three objectives of budget policy long advocated by Mr. Musgrove.¹¹ Taking into consideration the nature of the Soviet system, we shall try to test the performance of the Soviet state budget in each field of these three objectives.

1. Resource allocation.

In the Soviet system, almost all economic activities are planned. The allocation of important resources, such as raw materials and equipment is, in theory, precisely accomplished by direct control. Other goods are distributed by the market mechanism. For those goods distributed by market mechanism, prices become very important. If the market is to conform with the plan, the following must be maintained :

- 1) Goods and services must be priced in an economically meaningful way.
- 2) There must be equality of demand and supply for each and all goods and services.

11. See Musgrove *Theory of Public Finance*, p. 5.

3) The economic incentives which insure that the planned distribution of funds leads to the planned allocation of goods and services must be maintained.¹²

The incentives are the consumer incentive to maximize satisfaction from expenditure of money income, the worker incentive to maximize earnings and the managerial incentive to produce efficiently and to minimize costs.

For those resources which are directly allocated through state control, equality of supply and demand and the incentive system becomes meaningless. But a price system is quite important for those resources directly allocated as well as for those allocated by the market mechanism. This is so primarily because of the interdependence of economic sectors. Prices in the Soviet system are arbitrarily manipulated. They are equalized with costs of production in certain industries, kept below costs for others, and set high upon costs for a third group. No opportunity costs are taken into consideration in allocating resources.

Labor as a factor of production is allocated in most cases through market mechanisms where a free market exists. Labor allocation depends on the one hand, on the success of the differential wage policy as modified by taxes, and on the other hand, on the success with which the Soviets allocate labor where there is no free labor market. The differences in earning of the labor force in the Soviet Union approximate differences in productivity as Bergsom¹³ concluded. If this is so, the tax system does not interfere seriously in the allocation of the labor force.

Raw materials and equipment are allocated by the general plan, using the profit-subsidy device to shift resources from consumer industries to producer industries.

In all of these cases the budget plays a leading role. Capital investment and subsidies are channelled through the budget expenditure. On the other hand, budget revenues, mainly by turnover tax, control the household purchasing power to adjust the allocation of consumer goods.

12. Holzman, *Soviet Taxation*, p. 293.

13. Abram Bergsom, *The Economics of Soviet Planning* (Yale University Press, 1964), p. 107.

2. Distribution of income.

There is no ideal concept of income distribution in the Soviet society. The original formula of the Communist phrase, "To each according to his need", has long been obsolete. The problem of economic incentive led to the new formula, "To each according to his work". The wage differential to wage workers for higher productivity and the bonus system for directors of national organizations resulted in different levels of income distribution than the ideal Marxist concept of absolute equality.

Although it is difficult to argue that the Soviet tax system is progressive, proportional or regressive, it is a well established fact that the Soviet tax system is designed for income distribution. The budget expenditure is the most effective tool of income distribution. Budget expenditure on social and cultural measures offer education, health services and social insurance for the Soviet citizens irrespective of how much they earn. However, since work is the only source of income, income distribution tends to be equitably distributed more than in any other society.

3. Stability and growth.

Unemployment, inflation and high rates of growth are the uneasy triangle facing the fiscal policy in a free society. To maintain high rates of growth and secure full employment with stable prices is not an easy task to deal with. In the Soviet Union unemployment is virtually nonexistent. This is primarily because of the state control and secondarily because of the rapid economic expansion of the Soviet economy. Unemployment is not a problem in the Soviet Union, at least for the time being.

As to growth rates, the Soviet system's performance is striking. High rates of growth have been maintained for a long time through intensive capital investment financed by the budget and retained profits. However, the direction of investment into enterprises that yield a quick return probably exaggerated the capability of the Soviet system to maintain such high rates of growth.

The problem of inflation, as was mentioned in Part I, was brought about by rising wage rates over the planned rates. The inflationary gap thus increased due to the shortage in the supply. The type of inflation that existed as open inflation in the thirties and suppressed in the post-war period is both a demand pull and a cost-push variety. As a demand-pull inflation, the excess of wage rates over the planned rates increased the demand over the planned supply in the market. And as cost-push inflation, the rise in wages did increase the costs of production and thus increased the prices. That is because the factory price is equal to :

Factory price = cost of production + factory profit + turnover tax.
Given fixed rates of turnover tax, and fixed profit rates, the increase in the costs of production will be due to the rise in the wage rates. The factory price will increase with the same amount of increase in the costs of production.

However, the bank control over wage funds as described in Part I of this paper reduced substantially the danger of inflation. Theoretically the inflationary gap could be eliminated only by equating the demand and supply in the market, either by increasing supply – and this does not seem to be probable in the near future – or by controlling the wage fund completely – and this does not seem possible either. Wage differentials for incentive purposes, the enterprise funds, and the availability of short term credit are all factors which contribute to the increase in take home income and subsequently the increase in demand over supply. A third alternative to cope with inflation is by monetary reform. The 1961 ruble reform was used as a device to ease the inflationary pressure and it seems that the Soviets will resort from time to time to such measures.

Trends of the Budget.

The increase in the Soviet budget as shown in Table VI is due to :

- 1) Cost inflation in the socialized sector of the economy because of the increase in the wage rates.

2) Increase of the socialized sector of the economy. The private sector is virtually wiped out by social pressure and discriminatory tax rates.

3) Increases in the real national income.

TABLE VI

Soviet State Budget 1957-66 in Billion Rubles

Year	Revenue	Expenditure	Surplus
1957	61.5	60.4	1.1
1958	64.2	62.7	1.5
1959	72.3	70.7	1.6
1960	77.2	74.5	2.7
1961	78.9	77.8	1.1
1962	84.3	82.15	2.16
1963	89.5	87.00	2.54
1964	94.4	92.23	2.18
1965	103.5	102.7	0.8
1966	105.5	105.39	0.14

Source : C.D.S.P. (1956-1966).

Note : The figures given are expressed in the new ruble value as of 1 to 10 of the old ruble. (See C.D.S.P., June 1960).

With the expanding economy of the Soviet Union, rising productivity, and central control, the budget is expected to increase in size through time.

Conclusions

The Soviet state budget is a remarkable fiscal achievement. It has proved to be a very effective instrument of economic control in coping with complex problems of a planned economy. Although the budgetary

system of the Soviet Union has experienced minor changes and adjustments, it is expected that it will undergo drastic change in the near future. The rigidity of the budget system and the centralized control is not likely to continue for a long time. For economic and political reasons, it is probable that decentralization is a necessary step toward a more dynamic fiscal policy and consequently a more efficient budget. The recent trends seem to confirm this conclusion.

The spread of economic activities to remote areas of the Soviet Union, the increase in population, and the complexity of the economy will lead to decentralization. It is expected that as part of this decentralization movement, the union-republic budget will become more important and will possibly become autonomous budgets. It is also expected that financing of fixed and working capital will be channelled through the state budget, and economic enterprises will be run on a self-financing basis. A quite important move has already been taken toward this policy by increasing the retained profits to 33 per cent of the total profits in each enterprise by 1960. The score of the Soviet performance as far as efficiency is concerned rates very low. It seems that raising efficiency standards through the budget has not been regarded as being successful. The Soviet economists are now debating a new device to cope with problems of wasted resources as well as better industrial planning, and that is the decentralization theme. Soviet reforms introduced by Mr. Kosygin in September 1965 and the series of introductions which followed, resulted in more freedom for industrial enterprise managers. Although the Soviet government has been very cautious in introducing and implanting the new reforms, those who conclude that economic planning and control is weathering away, and the future of Soviet economic planning would be no more than indicative planning in a socialist market economy, may prove to be right.