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Inflation in the Soviet Union

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Introduction

The subject of inflation is rarely mentioned in Soviet sources. The denial that inflation can exist in the planned economy is, in fact, a standard component of Soviet writing on money and finance. Moreover, maintenance of internal financial stability is a major Soviet policy objective; and it might be thought that, by virtue of the planning system and the complex of controls, the Soviet authorities are relatively well equipped to avoid inflationary disturbances. ^{1/}

Nevertheless, the Soviet Union has experienced inflation -- in the aftermath of World War I, almost continuously throughout the interwar period and, of course, during World War II. Since 1947, when a thoroughgoing currency reform wiped out wartime inflation, the regime has apparently been more successful in controlling inflation or, at least, in avoiding the spurts of wage and price inflation which characterized the period between 1928 and 1940. ^{2/}

^{1/} Examples of the denial that inflation can exist in the Soviet Union are familiar to most readers. The following statement by V. Garbuzov, USSR Minister of Finance, may be taken as typical, as well as authoritative:

"In the Soviet Union there is not and cannot be any inflation; the possibility of inflation is fully precluded by the very system of planned socialist economy. In our country both wholesale and retail prices are established by the government and, therefore, the purchasing power of the ruble is controlled on a planned basis....The stability of Soviet currency is guaranteed by the monopoly of currency and the monopoly of foreign trade which is one of the most important advantages of the socialist economic system."
Pravda, November 15, 1960, page 2.

^{2/} Franklyn D. Holzman, "Soviet Inflationary Pressures, 1928-1957: Causes and Cures," The Quarterly Journal of Economics, LXXIV, No. 2 (May 1960), pp. 167-188. Holzman's article provides an excellent review of Soviet inflationary experience. The emphasis is on the prewar period. Although Holzman deals in part with the postwar years, his analysis ends with 1957, a year which may be said to mark the impact of the newer inflationary experience with which this note is concerned.

During the past five years, however, inflation seems once more to have become a problem. The current problem stems from the tendency for income expansion to outstrip increases in consumer goods and services available to the public. The existence of inflationary conditions, long suspected by numerous Western students, has been confirmed by Khrushchev and other Soviet spokesmen on a number of occasions in the past two years.

The expansion in incomes is the result of policies which the post-Stalin leadership has pursued in an effort to improve monetary incentives. The failure of consumer goods and services to expand sufficiently to absorb the higher level of consumer demand is due primarily to the pressure on resources of higher priority objectives, such as continued heavy industry expansion because of the commitment to rapid economic growth, and recent Soviet space and defense programs. It is also possible that the Soviet planners underestimated the problem caused by the imbalance between consumer demand and the supply of consumer goods. In recent months, however, the authorities have taken anti-inflationary action, first by raising retail prices for meat and butter on June 1, and on September 24 by announcing the indefinite postponement of scheduled cuts in income taxes.

Postwar Soviet price and income policies

Earlier intermittent discussion in Soviet publications makes it clear that the principal cause of inflation has been a substantial rise in recent years in money incomes of large groups among the Soviet population, a development not matched by a sufficient expansion in the availability of consumer goods and services. The expansion in incomes results from a basic change in Soviet price and income policies introduced soon after Stalin's death in 1953.

Up until 1954, Soviet policy aimed at maintaining stability in money incomes while retail prices were reduced in line with productivity improvements. Since 1954, the authorities have followed a policy of maintaining a relatively stable level of retail prices.^{3/} At the same time the regime has improved money incomes by selective wage and salary increases and by certain other measures which have raised "take-home" pay. Occasional price reductions decreed since 1954 have been of limited significance. Moreover, since 1954 there have also been some price increases, prompted primarily by social objectives: higher prices for vodka and other alcoholic beverages were part of a serious campaign against drunkenness, while very large price increases for automobiles and some other consumer goods were aimed at combatting the activities of speculators.

Some of the measures which have led to a significant improvement in Soviet incomes were introduced soon after Stalin's death, but many of them took effect in 1957. The regime has raised minimum wages and pension payments, has reduced some taxes and abolished others, and has eliminated some specific consumer charges -- tuition expenses, for example. These programs, along with measures like the elimination since 1957 of the annual compulsory mass sale of government bonds, have either raised incomes directly or have freed income for other uses. In the important field of agriculture, a succession of general increases in purchase and procurement prices has brought about

^{3/} Colin D. Campbell and Rosemary G. Campbell, "Soviet Price Reductions for Consumer Goods, 1948-1954," The American Economic Review, XLV:4 (September 1955), pp. 609-625.

a significant improvement in the income standing of the Soviet peasants -- undoubtedly the single most depressed group in the entire Soviet population. 4/

The Seven-Year Plan (1959-65) provides for a continuation of many of these income and "welfare" programs. At this writing, increases in minimum wages and pensions over the next few years are still part of the program. However, the scheduled elimination of individual income taxes by the end of 1965 has been interrupted by the announcement, on September 24, of an indefinite postponement of the income tax cut due to go into effect on October 1. This action, taken together with the retail price increases on June 1 of this year, suggests that the authorities have realized that effective action is required in order to prevent an intensification of the existing inflationary situation.

Effects of price and income policies

The implications of the modifications in price and income policies associated with the Khrushchev regime are fairly clear. The present Soviet leadership decided to raise income levels and, especially, to better the income position of previously less-favored groups, because of a pressing need to improve labor efficiency at a time when labor force growth had slowed down. Alternatively, Khrushchev's policies can be regarded as evidence of recognition that a different pattern of income distribution was needed in order to encourage a larger measure of participation in the effort to achieve ambitious economic plans.

Stalin's policy of cutting retail prices while maintaining wages and other incomes generally unchanged left the distribution of consumer purchasing power unaltered, that is, new supplies of consumer goods were channeled largely along existing lines of income distribution. So much was implied by Khrushchev, who once said that the policy of cutting prices benefitted chiefly those who already had enough money for their needs. 5/ Under Stalin, the generally low levels of individual incomes, and the consequent lack of any significant margin of free income available after expenditure on basic needs, did not permit the vast majority of Soviet consumers to share in the benefits of lower prices. That would have been true even if goods had been in plentiful supply, which was not the case by any means. Clearly, income distribution was becoming more unequal in Stalin's last years.

4/ Alec Nove, "Toward a 'Communist Welfare State'?" Problems of Communism, IX:1 (January-February 1960), with commentaries by Schwartz, Wolfe et al); and " 'The Communist Welfare State': Discussion," Ibid., IX:3 (May-June 1960). See also Lynn Turgeon, "Levels of Living, Wages and Prices in the Soviet and United States Economies," in Comparisons of the United States and United States Economies (Washington, United States Government Printing Office, 1959), Part I, pp. 319-340.

5/ Speech to the USSR Supreme Soviet, May 5, 1960, Pravda, May 6, 1960, page 2.

It is also significant that the new income and welfare programs have brought about a change in the nature of consumer goods markets in the Soviet Union. The inadequacy of over-all production in the earlier postwar period was reflected in waiting lines and general shortages -- always constant elements of the Soviet scene. Waiting lines are still common enough, of course, but nowadays shortages are to an increasing extent localized in nature, and often reflect imperfections in the distribution system. In addition, the cumulative effects of income gains by previously less-favored groups, together with the planners' persistent neglect of quality and style in the assortment of goods produced, has brought about an unusual degree of consumer resistance. This shift from a seller's to a buyer's market for some consumer goods has occasionally led to the underfulfillment of retail sales plans and to some unplanned accumulation of retail inventories. In recent years, the authorities have become increasingly aware of the necessity of gearing production more closely to consumer demand, but there is a real question whether this adaptation is possible under the Soviet system. ^{6/}

Khrushchhev's several public references to inflation confirm our understanding that, up to the present time, the expansion in Soviet incomes has not been matched by a proportionate increase in consumer goods and services. ^{7/} The much publicized consumer goods program of the short-lived Malenkov period (1953-55) was tacitly abandoned, in the sense that announced targets for output increases were not met.

^{6/} In recent years the specialized Soviet literature has contained some discussion of this question, as well as of such perennial problems as the improvement of quality of consumer goods, more efficient ways of organizing and servicing retail establishments, methods of forecasting consumer demand, and the like. These Soviet writings, together with some experimentation with advertising, instalment selling, the limited introduction of self-service systems in retail shops, etc., have led some Western students to argue that the Soviet Union is on the verge of a "marketing revolution," or that it is beginning to acquire the characteristics of the affluent society. This sort of speculation is interesting and suggestive but, in this writer's opinion, somewhat overdrawn. See D. Maynard Phelps, "Soviet Marketing -- Stronger Than We Think," Harvard Business Review, July-August, 1961, pp. 69-80; and Marshall I. Goldman, "Product Differentiation and Advertising: Some Lessons from Soviet Experience," Journal of Political Economy, LXVIII:4 (August 1960), pp. 346-357. The applicability of the concept of the affluent society to Soviet conditions has been very effectively treated by William N. Turpin, "The Outlook for the Soviet Consumer," Problems of Communism, IX:6 (November-December 1960).

^{7/} Any number of relevant references might be cited. See, for example, the resolution of the March 1962 Central Committee plenum on agriculture, and Khrushchhev's closing speech, in Pravda, March 11, 1962.

Although modest increases in consumer goods supplies continue from year to year, they have not been sufficient. Two and three years ago, it was customary to say that, despite shortages for many goods, the basic food needs of the Soviet population were being adequately met, in quantity if not in quality. In the light of Khrushchhev's criticisms of unsatisfactory levels of agricultural performance this year and last, his admission that food needs are not being satisfied, and his defense of the need to raise meat and butter prices in order to curtail demand, even such claims can no longer be made.

Unfortunately, the existence of inflationary conditions in the Soviet Union cannot be statistically demonstrated, owing to the absence of adequate information of the sort which is commonplace in most other countries, such as data on the money supply, on money wages and other incomes, on income distribution, and the like. ^{8/} It is undeniable, however, that the gap between income expansion and consumer goods output has reduced the value the public places on money, even though this fact is not reflected in prices, which are controlled. ^{9/} Instead, the erosion in the value of money is reflected in such manifestations of suppressed inflation as increased absenteeism and continued high labor turnover. It is possible that the fairly rapid improvement in incomes, coming after a prolonged and no doubt vividly remembered experience of deprivation, has encouraged attitudes of resignation or lethargy simply

^{8/} Data on the Soviet money supply have not been available for well over a generation. Information on Soviet incomes is most unsatisfactory, and the major gaps are well known to most researchers. Some information is available on the income increases stemming from increases in minimum wages and pensions, as well as the gains in disposable income from tax cuts (through 1961), the elimination of compulsory bond sales, and some of the other "welfare" programs. See the sources cited in footnote 4.

^{9/} Indices of Soviet prices are available only on an annual basis, and at this writing, 1959 is the most recent year covered by official statistics. Except for the increase in State retail prices because of the price increases on June 1 of this year, no change in the general level of State retail prices is known to have taken place since the end of 1959, although there have been minor reductions of limited significance. The influence in various changes in certain categories of wholesale prices -- increases in farm producers' prices, some decreases in prices to farmers of fuel, machinery spare parts, etc., -- cannot be determined. In addition, the authorities plan some changes in wholesale prices, to take effect at the end of this year, as part of a comprehensive revision of heavy industry prices and transport rates ordered by the Central Committee in July 1960. The proposed changes in fuel prices, which is the first part of this planned revision, appears to involve a change in the structure rather than in the general level of wholesale prices, according to an article in the December 1961 issue of Finansy SSSR. This point was apparently obscured by an account of the change which appeared in The New York Times of February 20, 1962.

because the hunger for consumer goods has been frustrated after an initial whetting of the public appetite. There is ample evidence -- for example, in the assignment by Khrushchev of a large share of the blame for poor agricultural performance on inefficient and disinterested management, on poor attitudes toward work, and the like -- that something like this may very well be the case.

Suppressed inflationary conditions may also account in part for the recent apparently serious increase in black market and other illegal activities. This evidence is difficult to interpret because such activities have always been a feature of day-to-day Soviet life. It may well be that the apparent increase in these activities is a mirage because all that has happened is that they are being more frequently written about in Soviet publications. However, if one chooses to believe that illegal activities have greatly increased, and that they are in some way symptomatic of monetary disorder, then it is possible to make an explanation along the following lines. It is that the post-Stalin "liberalization" of political and economic life -- the elimination of the most repressive features of the previous regime, and the institutional changes which have encouraged a greater degree of initiative and decision-making at local levels in the chain of command -- have created what might be termed a climate of greater permissiveness for these activities. Further evidence that these activities have increased to an alarming extent is the rash of punitive legislation adopted in the Soviet Union in the past year, which in some cases provides the death penalty for a variety of economic "crimes." This reversion to the Stalinist style must be taken as a measure of the seriousness with which the authorities view the problem of illegal activities.

Policy implications

In view of the money-goods imbalance resulting from the more rapid expansion in incomes than in consumer goods and services, the Soviet authorities would seem to be faced with two alternatives. The regime could permit a more rapid improvement in the standard of living if it considered that a point had been reached at which additional resources could be committed to the consumer goods sector. Alternatively, it could employ fiscal and monetary instruments to deal with the inflationary situation, or it could postpone the scheduled programs of income and welfare measures.

So far the regime has not been willing or able to undertake a large-scale effort to expand the supply of consumer goods and services. Improvement will continue to be made, of course, but the pace will probably remain a gradual one. For the time being, the regime appears to be counting on improvements in productivity resulting primarily from the more efficient utilization of existing plant and equipment. Because the consumer goods sector has long been the residual claimant on economic resources, and is therefore the sector in which the use of antiquated equipment and outdated production methods is most widespread, opportunities for productivity gains may be favorable. These gains are in part what the more intelligent monetary incentives provided by the Khrushchev regime are designed to achieve; but the regime also relies on a very large measure of exhortation in pushing this objective. ^{10/}

^{10/} The "utilization of existing (or hidden) reserves" is the usual Soviet euphemism for this sort of activity, which takes the form of organized campaigns for everything from collection of scrap to raiding enterprises to uncover hoarded supplies.

Although the Soviet authorities have become increasingly concerned with the problem of maintaining internal financial stability, they had not taken definite anti-inflationary action until quite recently. However, when the effects of the rapid income expansion began to be noticeable -- after 1957 and 1958 -- the authorities evidenced their growing concern in a number of ways. For example, considerable publicity was devoted to the stimulation of individual savings, as well as to the purchase of individual insurance; annual increases in savings deposits and insurance premiums are counted as revenue in the Soviet State budget. In addition, the supervisory and regulatory powers of the central bank were continually stressed in recent years. In its official journal, the State Bank of the USSR repeatedly emphasizes the importance of speeding the return of excess cash to the banking system, and stresses the necessity for more effectively preventing any form of unplanned expenditure, such as the overpayment of wages or the use of bank credit for unplanned purposes. Undoubtedly, the institutional changes of recent years had encouraged an increase in infractions of financial discipline by Soviet enterprise managers. ^{11/}

Any discussion of the subject of recent Soviet inflation would be incomplete without mention of the Soviet domestic currency reform carried out at the beginning of 1961. It would seem appropriate to summarize the measure, since it obviously bears some relationship to the question of the value of money, but we may anticipate our

^{11/} Although this assertion cannot be proved it is based on study of the specialized financial literature over a number of years. In the article cited in footnote 2, Holzman explains the apparently more successful postwar Soviet experience in dealing with inflation partly in terms of improved State Bank controls over wage expenditures. There is no reason to question this argument for the period through 1957. In his conclusions, Holzman also recognizes that the controls over wage expenditures have not been completely effective. My own impression of some increased laxity in the effectiveness of these controls since 1957 and 1958 is related to my argument that the important institutional and organizational changes in the administration of the Soviet economy have encouraged an increase in all sorts of financial irregularities.

In so brief a note, it is not possible to deal with the interesting question of the way in which unplanned credit expansion (and more numerous infractions of financial discipline) lead to an expansion of the money supply, or of the connections between cash money flows among segments of the economy. The interested reader should consult Holzman's article, as well as the discussion in Thomas Wilson, Inflation (Oxford, Basil Blackwell, 1961), Chapter VIII, "A Note on Inflation in Russia." In a recent article, Gregory Grossman presents a highly suggestive discussion of the degree of monetization of the Soviet economy, a topic whose relevance for the subject of this note must be obvious. See Gregory Grossman, "The Structure and Organization of the Soviet Economy," Slavic Review, XXI:2 (June 1962), especially pp. 212-215.

conclusion that the 1961 currency reform had little to do with the domestic inflationary problem. It was not designed to reduce the volume of money in circulation nor, except in a limited sense, to deal directly with the basic inflationary situation analyzed in this note.

The 1961 Soviet currency reform

The Soviet currency reform which became effective on January 1, 1961, comprised two separate measures: (a) establishment of a higher "gold content" and of new exchange rates for the Soviet ruble, and (b) the exchange of new currency for the existing issue, at the rate of 1 new for 10 old rubles, together with the reduction of all prices of goods and services, wages and the values of assets and liabilities to one-tenth of their former levels. The increase in the "gold content" of the ruble amounted to an implicit devaluation in terms of the former exchange rate, along with a slight appreciation of the former special exchange rate for tourism and certain other non-trade transactions.^{12/}

On the surface the domestic currency exchange and the cut in prices -- the creation of a "heavy" ruble domestically -- do not appear to have been motivated by anti-inflationary aims. Unlike the 1947 currency reform, the 1961 measure was not designed to eliminate currency hoards. It may be true that holders of unusually large amounts of currency for which they could not satisfactorily account may have been inhibited from presenting all of their holdings for exchange, or have been unsuccessful in arranging for exchange through third persons. In addition, the exchange had the effect of wiping out foreign holdings which had been created by illegal exports of currency over the years. But the effects of these two aspects of the exchange in contributing to a reduction in the volume of money in circulation, after completion of the domestic exchange at the end of March 1961, cannot have been significant.

The reasons officially advanced in explanation of the domestic currency exchange were certainly unobjectionable. The advantages claimed -- that introduction of a more valuable domestic currency would simplify bookkeeping and encourage greater attention to economy in the use of money -- do not appear to be of major importance. It may be true that the introduction of a new ruble and new price scales simplified economic calculations. A more important point may be that the introduction of a new currency with a relatively high purchasing power can re-create confidence in a currency after a period during which it has gradually eroded. Some evidence exists to support

^{12/} See Morris Bornstein, "The Reform and Revaluation of the Ruble," The American Economic Review, LI:1 (March 1961), pp. 117-123. The international implications of the change in the foreign exchange value of the ruble will not be dealt with in this note, the purpose of which is to present an analysis of the Soviet domestic inflationary problem. As Bornstein makes clear, the two aspects of the 1961 currency reform are quite distinct.

this point of view. ^{13/} From the psychological standpoint, it may not have been unreasonable for Soviet spokesmen to claim that creation of a new currency would strengthen income incentives.

In view of the evidence reviewed in this note, the interesting question is why the Soviet authorities took no action to reduce the volume of money in circulation in 1961. We cannot answer this question with any assurance, although we may perhaps speculate that a domestic exchange which provided for anything less favorable than an equal ratio of old to new money (with a neutral offsetting adjustment in prices) would have substantially diluted the obvious propaganda advantages which the Soviets derived from being able to claim a strengthening of the monetary system. All the same, in view of the many references to monetary disorder in the specialized literature at the time, the growing imbalance cannot have been unknown to the responsible authorities. ^{14/}

Recent anti-inflationary action

In recent months, however, the regime has apparently decided that the time has come to adopt more powerful anti-inflationary measures, and has taken two steps along these lines. On June 1, retail meat and butter prices were raised on the average by 25-30 per cent, in conjunction with higher prices to producers. Unlike previous increases in farm producers' prices, which were financed primarily by reductions in turnover taxes, the difficult and no doubt controversial decision to raise retail prices for these products was undoubtedly made in the full realization that this is the most effective way of curtailing demand.

^{13/} Any reader who visited the Soviet Union before the currency reform -- in 1959 or 1960, for example -- might have noticed the virtual disappearance of small coins from circulation. A number of readers of the Soviet press in the same period will recall accounts of retail stores providing small change in the form of matches because of the shortage of small denomination money. These are typical manifestations of an erosion in the value of money. More recent visitors to the Soviet Union may, like the author, have encountered expressions of dissatisfaction with the new currency in the form of complaints that, with the new scale of prices, money appears to "slip through one's fingers." This too, is an indication of the difficulty of overcoming the habit of treating the new currency as if it were the old; it "isn't worth much," so that it can be expended without elaborate calculation. It is difficult to judge the importance of these psychological elements.

^{14/} At the time, there were a number of official denials that the currency exchange was being undertaken for the purpose of reducing the volume of currency in circulation. But it is difficult to take seriously statements like the following, by Korovushkin, Chairman of the Board of the State Bank of the USSR:

"It can be said without exaggeration that our monetary circulation is now in a better state than it has ever been." (Pravda, May 13, 1960, page 3.)

On September 24, the Soviet press published a decision to postpone "until further notice" the scheduled income tax cuts which would have become effective on October 1, in accordance with 1960 legislation providing for the gradual elimination of individual income taxes by 1965. This second anti-inflationary action was said to be necessary to help pay for further economic development and increased defense preparedness, and blame for the decision was placed on the "heightened international tensions" created by the United States. Whether this explanation is real or fancied is a matter of speculation; it is clear that, as in the case of the retail price increases of June 1, the Soviet consumer's expectations of continued improvements in the standard of living are being given a check. However, if the regime cannot decide to embark on a program to improve consumer goods output, it makes sense at last to move with some vigor to correct the inflationary imbalance which has been created by its income and welfare programs.