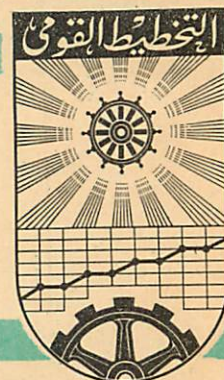


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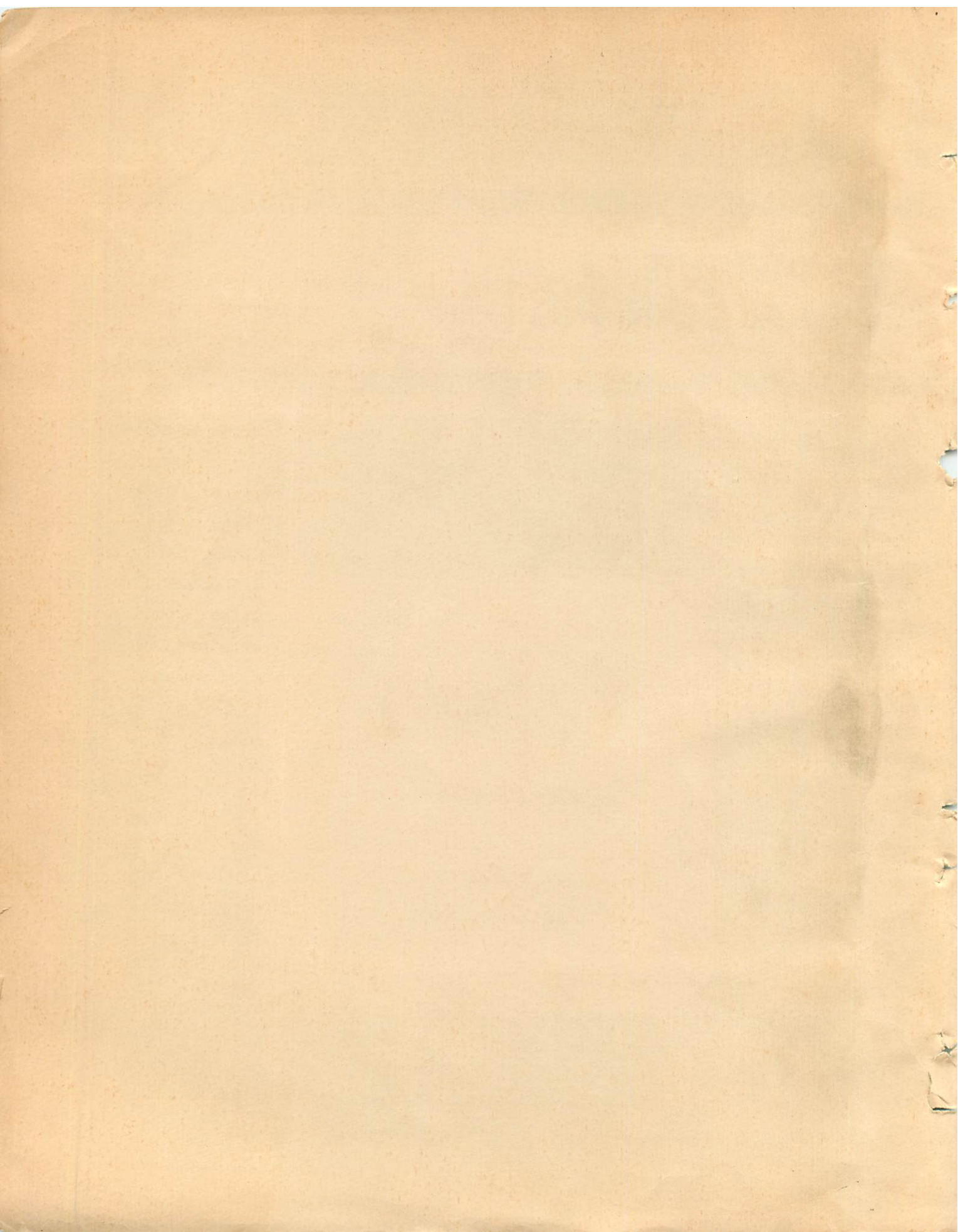
Financial Mechanism of a
Socialist Economy

(on Poland's Example)

by

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I. Financial system of a socialist economy.

1. The structure of the financial system.

The socialist economy is composed of many units, which are economically independent, such as socialist (i.e. state and collective) enterprises, private enterprises, individual consumers etc. This economy is managed in a planned manner, which imposed a certain limitation on the independence of the economic decisions taken by separate units. The instruments of limiting the freedom of economic decisions are of different types, as for example the general prescriptions of the civil law, the direct orders given by upper organizations (National Planning Office, Ministries etc.) and the indirect instruments stimulating directions of decisions according to the objectives of the general plan. The financial system is playing an important part among these instruments. All economic decisions - in order to be effective - must be connected with the means sufficient to put them into execution. This means that the plan regulating the monetary revenues and expenditures of the independent economic units may be an efficient instrument of managing their economic activity. The planned regulation of monetary revenues and expenditures is the main objective of socialist financial system.

This system is composed of the following main parts:

- a) The financial system of the socialist enterprises which includes the state enterprises and the collective ones, both being in general very similar, but different in some important questions, as well as the industrial, commercial, agricultural and others enterprises, each of them having its own branchial characteristics).
- b) The state budget, which serves in general as an instrument of appropriating the financial means among all the branches of the national economy and as an instrument of financing the activity of the state in non-productive sectors, such as education, public health, administration, national defence etc.

(2)

c) The insurance financial system, which is practically reduced to the financial activity of one state organisation of "general insurance", dealing with material goods, Social insurance being included into the state budget.

d) The financial system of banking and credit.

There does not exist a separate financial system for the population (individual consumers) and private enterprises, as a result of their independence of the state. The ^{pre}scriptions, regulating financial relations between individuals and socialist organisations (state budget, enterprises, banks, insurance company) are included in their respective sectors financial systems.

2. Financial system of socialist enterprises (a short outline)

The most important source of monetary revenues of enterprises is the sale of goods and services. The sale is effectuated at prices fixed by the state organs, save exceptional cases in which the price of individually commanded and produced goods may be fixed by contract between sellers and buyers (this is the case of very special investment goods). The industrial enterprises sell their products at so-called industry sale prices, the wholesale commercial enterprises sell them at wholesale prices (industrial sale prices increased by wholesale margin), the retail commercial enterprises sell them at retail prices (wholesale prices increased by retail-margin). The retail prices are fixed by the state organs at the presumed equilibrium level of supply and demand, and wholesale prices and industry sale prices are deducted from retail prices.

As a rule, the industrial sale prices cover not only planned average costs of production (the use of capital equipment included) but also give a surplus, which is called "monetary accumulation" (gross benefit). This is the main source of financing state expenditures: both productive and non-productive ones. The management of the gross benefit of the socialist enterprises is one of the most important problems of the financial system.

The gross benefit of each enterprise must be divided between centralized funds (state budget among them) and the decentralized ones, in order to

(3)

allow to finance both centralized expenditures (big investments, all non-productive expenditures of the State), and decentralized expenditures (small investments decided by enterprises themselves, participation of workers in, net benefits, bonuses etc.). The instrument of dividing the gross benefits is the turnover tax.

In most cases the rates of the turnover tax are calculated individually for each commodity. These rates are calculated as the difference between industry sale price and the so-called "plant price" of each good. The "plant price" includes:

- average planned costs of production.
- rate of net profit.

Average planned costs of production are calculated for all enterprises putting out a given kind of goods. Of course, each of these enterprises may produce this kind of goods at different costs, according to differences in capital equipment, productivity of labour, natural conditions, etc. But the turnover tax is fixed at equal rates on this good unit from every enterprise, regardless of these differences. This means that the rate of profit included in the "plant price" is also an average one, and that in reality the rates of profit in each enterprise of the same branch of industry are different. In some special cases, when the differences in individual costs of production of single enterprises are extremely high (and it happens especially in mining, where the influence of natural conditions of production on costs level is very great) some of the enterprises have deficits instead of benefits. In such cases, the trust (Union of enterprises of the same branch) organises the repartition of benefits among enterprises, in order to cover the deficits of those working in unfortunate natural or economic conditions, by the over-average benefits of the other ones, working in better conditions.

The turnover tax flows directly to the State budget. The rest of the "gross benefit" of the enterprise after deduction of the turnover tax is called its profit.

It is necessary to underline that the rates of profit, included in "plant prices" of different commodities are equal, or differentiated deliberately,

when it seems advantageous in order to stimulate or to limit the output of certain commodities. When it happens (rather seldom), that the "plant price" is higher than industry sale price of certain goods - the rate of turnover tax gets a negative value, meaning that the producer of such a commodity instead of paying the tax receives an allowance from state budget for every unit sold. It is also necessary to underline that the turnover tax system (of positive and from time to time negative payments to the State budget) plays the regulating role only on the level of an industrial branch (trust, Union of enterprises) not on the level of single enterprises. The trusts being responsible for inter-branch economic policy, must look after repartition of benefits among their enterprises.

The profit of an enterprise is further divided. In state enterprises one part of the profit forms the so-called "bonuses fund" another part forms "fund of development" - and the rest is transferred to the trust. The rules of forming these funds are rather complicated. In general, a proportion is maintained between the bonuses fund and the loan fund and the increase of the benefit (as compared to the last year). The percentage rate of the share of the fund of development in the total benefit is fixed by the ministry of finance for the trust, and the trust is fixing it for each enterprise. These rates must be fixed for a period of no less than five years, in order to give the necessary perspective in planning self-financed development in every trust and enterprise.

The rest of the benefit has to be transferred by the enterprise to the trust's account. The trusts are obliged to transfer a fixed amount of these payments to the State budget, and are using the rest of them (a) for covering the planned deficits of other enterprises (b) for increasing the reserve-fund of the trust.

To summarize the system of formation and allocation of state enterprises gross benefits may be outlined as follows:

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Enterprise's Financial System

	Revenues from the sale of goods	R	
	(at industry sale prices)	-	
less	Costs of production	C	
equal	gross benefits	= A	
less	turnover tax (and allowances)	- T	state budget
equal	profit (or deficit)	= B+E	+g _L
less	"Fund of bonuses" formation	- C	
less	"Fund of the development" formation	- D	
equal	Transfer of profit to the trust	= F	
	<u>Trust's financial system</u>		
	Transfers from rentable enterprises.	F	
less	Allowances covering planned deficits and funds formation in deficitary enterprises	- E	
less	Trust's reserve fund formation	- G	g ₁ g ₂
			other purposes
equal	Trust's payments to the state	= H	state budget
	The fund of development of an enterprise is devoted to cover:		
	a) The expenditures connected with capital investments.		
	b) The expenditures connected with increasing stocks.		

Every state enterprise is equipped by the state with its own capital whose amount is equal to the value of a) capital equipment being at the disposal of the enterprise, b) standard amount of floating capital, i.e. value of standard stocks of raw materials, unfinished production, finished goods etc. The initial equipment of a new-organized enterprise is financed from budgetary funds. The main source of increasing the own capital ("own means" as it is called in order to avoid the word "capital") of existing enterprises is their fund of development. Only general reconstructions of existing enterprises, or creation of new plants within existing enterprises, may be financed from budgetary funds.

So, the rate of development of existing enterprises is regulated through the regulation of their rentability (price policy and turnover tax) and of the share of the fund of development in the net benefit.

The re-investment (renewal of existing capital equipment) being financed by amortisation fund, the fund of development is devoted chiefly to self-financing of new investments. But in practice, the amortisation fund and the part of development fund, devoted for investments, are unified in one fund called "the fund of investment and reconstruction". It may happen that this fund of investment, accumulated in a given year by a given enterprise, does not cover the amount of expenditure included by the enterprise in its financial plan. In such a case, the enterprise may apply for a bank investment credit. The investment credits are reimbursed from the accumulation of the investment fund in coming years.

The increase of standard stocks is planned by the enterprise independently. No directives are given in this area. But the enterprise is obliged to cover first the increase of the standard stocks from the fund of development, and only then is authorized to transfer the rest of this fund on account of the investment fund. This means that there is a competition between the needs for increasing standard stocks and the needs for new investments within an enterprise.

Standard stocks are planned, including permanent stocks of raw materials, unfinished production and finished products, needed in order to run normal activity. They do not include season or special stocks - these being financed exclusively by bank short-term credits. The bank short-term credits cover also the claims of enterprises emerging from the delay in settling the transactions in goods and services. The average period between the date of furnishing goods and the date of monetary settlement is of 12 days, so in the average, the bank credits granted to this purpose amount to 12 - days turnover.

The annual financial plan of an enterprise includes a summary table, which has the form of a balance-sheet of monetary revenues and expenditures. It is divided into 4 chapters as follows:

Financial plan for the year

(Simplified)

EXPENDITURESREVENUESChapter I: Gross Benefit & Net Benefit

1. Costs of sold goods and services	1. Revenues from sale of goods & services.
2. Turnover tax	2. Budgetary allowances
3. Net benefit	3. Net deficit
TOTAL	TOTAL

Chapter II: Repartition of the Benefit and Financing Deficit.

1. Net deficit	1. Net benefit
2. Bonuses fund	2. Allowances from the trust
3. Development fund	
4. Transfer to trust	
TOTAL	TOTAL

Chapter III : Own Circulating Fund

1. Increase of standard stocks	1. Part of development fund
2. Reimbursement of bank credit.	2. Bank credit
3. Transfer on investment fund.	3. Reduction of standard stocks.
4. Others	4. Others
TOTAL	TOTAL

Chapter IV : Financing Investments.

1. Costs of investments and renewal	1. Part of development fund ..
2. Reimbursement of credits	2. Amortization fund..
3. Others	3. Budgetary allowances
	4. Bank credits ..
	5. Others.
TOTAL	TOTAL

The annual plan does not include needs for the formation of over-standard stocks, or bank credits granted in order to cover them. This kind of financial operations is estimated only in quarterly plans.

In order to prepare their financial plans (year plans), the enterprises get some directive indicators from upper organisations. As a rule, these indicators include the amount or the rate of increase of the gross benefit (as compared to the previous year), the share of the fund of development in the net benefit, the budgetary allowances for investments (if any centralized investments are planned). The enterprise has to keep these directive indicators in its plan, or to establish its objectives above (when they indicate minimum revenues), or respectively under (when they indicate maximum expenses) their level. The enterprise's financial plan is not approved by anybody other than the director of the enterprise and the workers' council. But - as far as the financial needs of an enterprise have to be covered by bank credits - financial plans must be discussed with bank's office representative and the credit requests must be approved by the bank.

In quarterly plans enterprises estimate the fulfilment of annual plan's targets, especially of the formation of the benefit and their own funds, in order to correct the requests for credits formerly granted by the bank (credits of standard stocks, investment credits), and, besides, they calculate their needs of credit on over-standard stocks and of settlement-credits.

3. The financial activity of the population and private enterprises.

The planning of financial activity of the population and private enterprises, i.e. planning of their monetary revenues and expenditures, serves above all, as an instrument of maintaining equilibrium on the market of consumption goods and the production goods which are furnished to private producers (mainly small farmers). The inclusion of private production and individual consumption in the same financial plan - theoretically wrong - is in practice unavoidable as a result of the difficulties emerging from the separation of individuals' expenditures on consumption from their expenditures on production. For the purpose of analysis, of course, separate plans of individual consumption, of private agriculture (which in the only important private kind of production) and other private economic activity are

prepared but for operational work only one plan is drawn up, containing all financial relations between the socialist sector and particulars.

The main sources of monetary revenues of individuals are:

- a) Wages, salaries and other kinds of remuneration paid by socialist enterprises, organizations, institutions etc.
- b) pensions, allowances, scholarships etc. paid by the State budget (which now includes formerly existing separate social insurance fund),
- c) revenues from the sale of agricultural and others products to the socialist enterprises,
- d) indemnifications from estate insurance company,
- e) Bank credits,
- f) others
- g) reduction of monetary savings : a) on accounts,
b) in cash.

The main kinds of monetary expenditures of individuals are:

- a) Purchase of goods and services from socialist enterprises.
- b) Taxes and other payments to the State budget.
- c) Payments to insurance company.
- d) Reimbursement of bank loans.
- e) Others.
- f) Insurance of monetary savings : a) on accounts
b) in cash.

The balance-sheet of monetary revenues and expenditures of the population, whose main positions are given above, is not addressed to any special institutions as a target or directive for fulfilment. It serves as an instrument of coordination of different targets, included in different and separate plans, but on the basis of this balance-sheet even very important changes of directives given to different institutions may be imposed. For example, if it occurs that the estimated purchasing power of the population is not in accordance with estimated supply of goods and services (at fixed prices) - some measures must be taken in order to

equilibrate both quantities. It does mean, that or the estimated revenues, or expenditures of the population have to be corrected, and not only in this balance-sheet, but also in enterprises financial plans, state budget, credit plan etc. The analysis of the market equilibrium and the financial measures serving to its maintaining are a special problem, which will be separately treated.

Wages are planned on the basis of planned amount of employment and average wages. Every enterprise and office gets from its upper organisation a directive, indicating the maximum loan fund, which dare not be exceeded without authorisation. The upper organisation, e.g.) trusts and ministries, dispose of some reserve loan fund, which may be used in order to raise the given limits in emergency cases. Besides, during the year when new opportunities arise, due to overfulfilment of production plans, additional loan fund may be admitted in order to raise the average wages above the formerly planned level, or in order to exceed the planned amount of employment (but only on condition of keeping the planned level of labour productivity, which means that over-planned employment must be in proportion to over-planned production). As a rule, enterprises producing consumption goods are automatically authorised to surpass their planned loan fund in proportion to the over-planned output, while enterprises producing investment goods and all non-productive organisations may surpass the planned loan fund only upon explicit authorisation. The rigid control over the loan funds is executed by the banks.

The pensions, social allowances, scholarships etc., being paid from budgetary funds, are planned, within the planning of State expenditures, on the basis of demographic estimations (pensions, family allowances), statistical data on illness cases and accidents, prescriptions regulating amounts of indemnities etc.

Revenues from the sale of agricultural and other products, provided by the individual formers and other private producers, are planned within the financial plans of commercial enterprises, buying these products from private suppliers. These revenues are planned on the basis of estimation of agricultural production (less self-consumption and increase of stocks in farms and less direct supplies of these products to the town-population) and fixed prices.

The indemnities for losses of estate, paid by State insurance office, are planned also on the basis of statistical data, by insurance companies.

Bank credits granted to the population and private producers, are of four different kinds : a) investment ~~and~~ short-term credits for private farmers b) investment and short-term credits for others branches of private production c) investment credits for private house construction d) consumption credits, including credits granted to commercial enterprises in order to cover their claims arising from sale by instalments. Each kind of these credits, playing a different role in economic activity, is separately planned within the credit plan.

Other monetary revenues, received by the population, are of small importance and must not be treated in a detailed way. This item of the balance-sheet includes for example revenues such as gains from the State lottery etc.

The purchase of goods and services by the population-though as the first item of the expenditures part of the balance-sheet, is planned at the end, after all others.

The payments to the State budget, imposed on the population and private producers, are composed mainly of such as the tax on wages and salaries, income tax and turn-over tax (concerning only private producers and dealers except farmers) and land tax. The tax on wages and salaries is a progressive one, with rates growing from 0,5 % up to 15% of earnings. Exemptions are granted to numerous families, war invalides etc. The turn-over tax received from private producers and dealers is taken at small, constant (regardless of the amount of turnover) rates from 1 up to 5%. Income tax is progressive, with rates growing from 5% up to 65% of net benefit. Small handicraft enterprises, employing no labour power, except the owner, his family members and up to 2 pupils - are exempt from normal turn-over and income taxes but they pay combined turnover-income tax expressed in absolute rates. These rates depend on the kind of profession, the number of population in the locality where the enterprise is situated etc. The land-tax is imposed on the basis of estimated (not realised) income of the

farm, this income being calculated according to standards fixed for 1 hectare land in different amounts, according to (a) economic area (the whole country is divided into three areas, according to the level of economic development), (b) economic zone where the farm is situated (there are five zones, distinguished for the purpose of land taxation : big towns, near to town zones, country zones distant country zones), (c) Kind of land (plough land, pastures and meadows, forests) and finally (d) the class of land (there are distinguished 6 classes of plough land and 5 classes of pastures and meadows, according to their fertility, all forests belonging to only one class). The relation between the lowest and the highest standard of income from 1 hectare land is about 1 : 40 . The rates of land-tax are progressive, growing from 5 up to 36% of estimated income, but many exemptions and alleviations are granted in different cases. It must be underlined, that all income above the standard level is free of taxation, what has for purpose to incite private farmers to intensification of their production. In practice the standards of income, used for taxation, are rather far below realized income level from 1 hectare , so the real burden of the land tax is estimated on the level of the half only of its nominal rates.

The payments to the insurance company result^{*)} from the contracts concluded between this company and private firms and persons. There are many kinds of insurance contracts, some of them being obligatory (for example insurance against the risk of fire for private farmers). These payments are planned by the state insurance company on the basis of statistical forecasting.

The payments resulting from the reimbursement of bank loans, formerly granted to the private sector (and to the state and cooperative shops as reimbursement of claims emerging from the sale on instalments) are planned in the four formerly mentioned groups within the credit plan. In some cases a part of credit indebtedness of private farmers and persons may be reduced

*) Beside taxes and duties, the payments to the state budget include also fees for different services executed by State organs, as for example rents for flats in nationalized houses, fees for medical services (paid only by persons, not participating in social security organization, what is the case of private farmers) and so on.