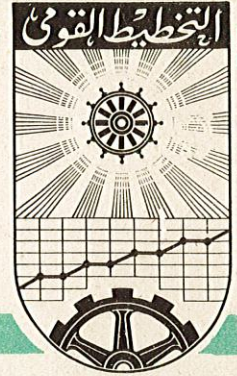


UNITED ARAB REPUBLIC

THE INSTITUTE OF
NATIONAL PLANNING



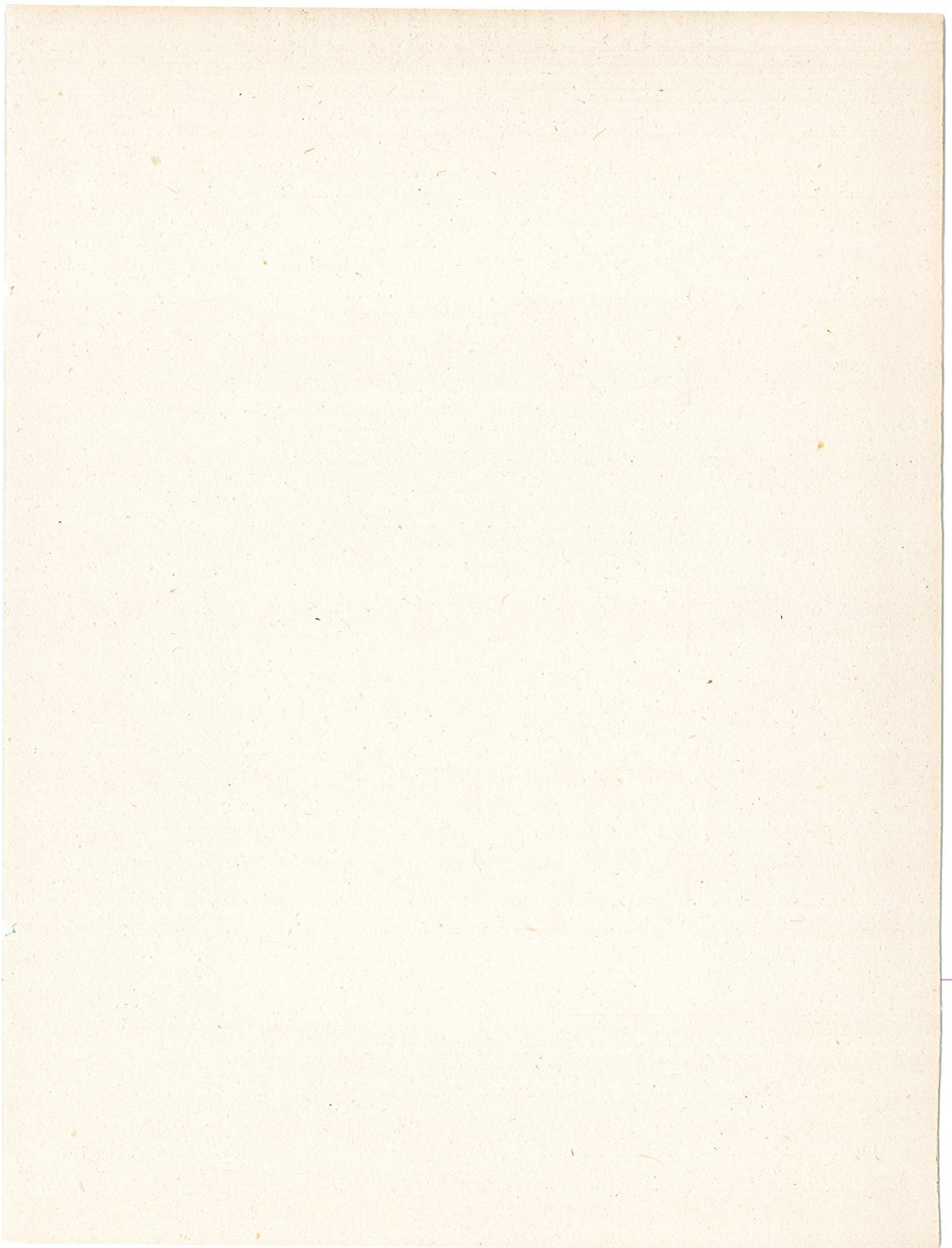
Memo No. 952

"The Financial System of the G.D.R."

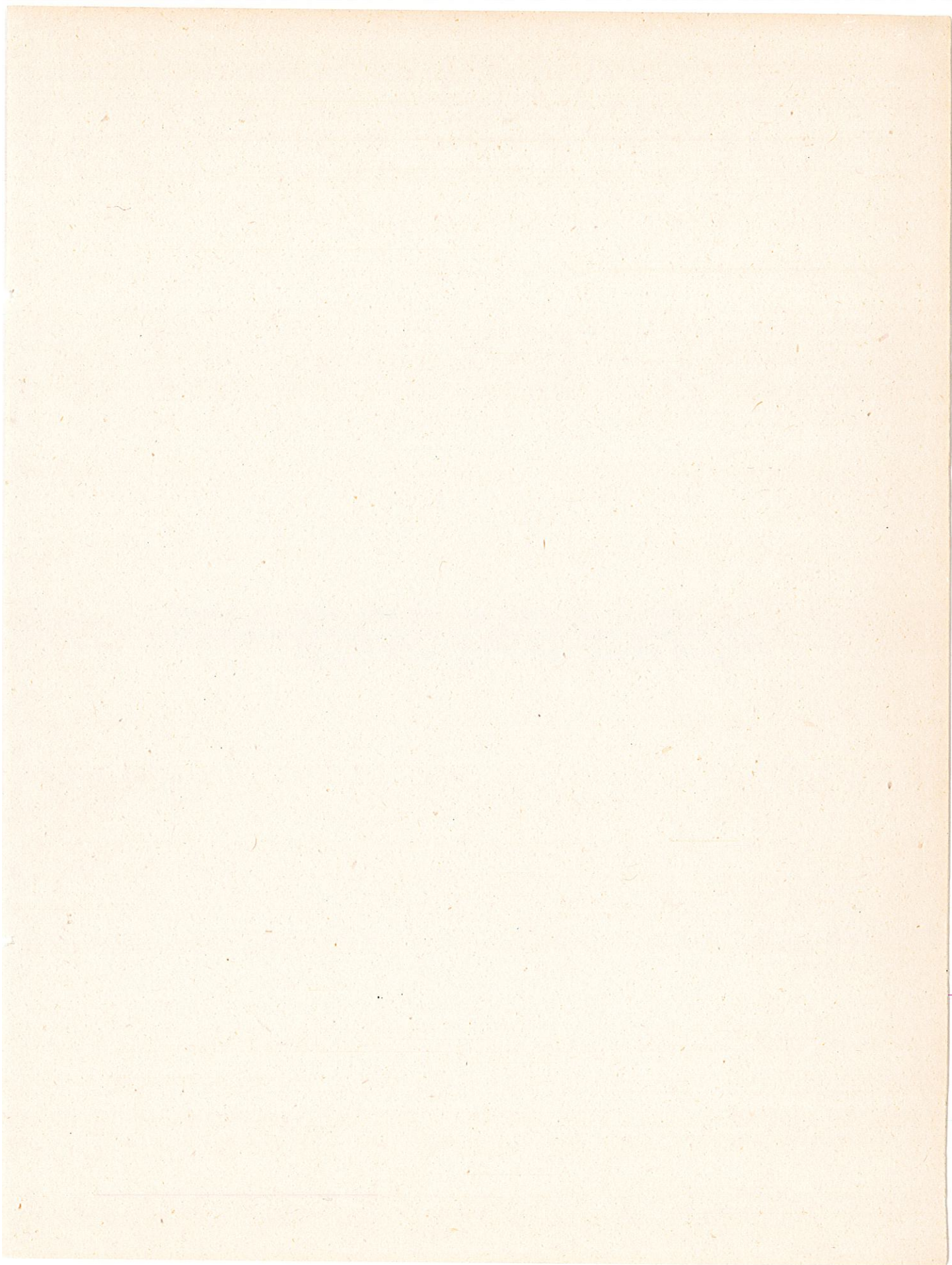
By

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Avril 1970.



"Opinions Expressed and Positions Taken by Authors
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The Financial System of the G D R

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In socialism the financial system is part of the economic system and closely connected with the development of all other partly-systems of the socialist society (production, distribution, consumption, education, health etc.)

The financial system has to focus the goals of the development process of the whole society which is a comprehensive plan including all partly-plans and harmonising them to a common goal. The most important role of financial system is to improve the efficiency of the national economy and to secure the activities of the state respectively.

Further the financial system has to support the development of all forms of socialist formation in the society and to control the development of the other still existing social formations, (private and semistate sector).

In the G D R the political power of the workers and collective farmers is exercised in cooperation with the intellectuals and the other working people. The economic basis is socialist ownership of the means of production which exists in two forms, nationally-owned and cooperative. In the G D R the state property, the nationally owned property, is the predominant form of ownership. This fact and the development of the socialist ownership of the means of production and its significance-expressed in the share of national income is demonstrated in the following table

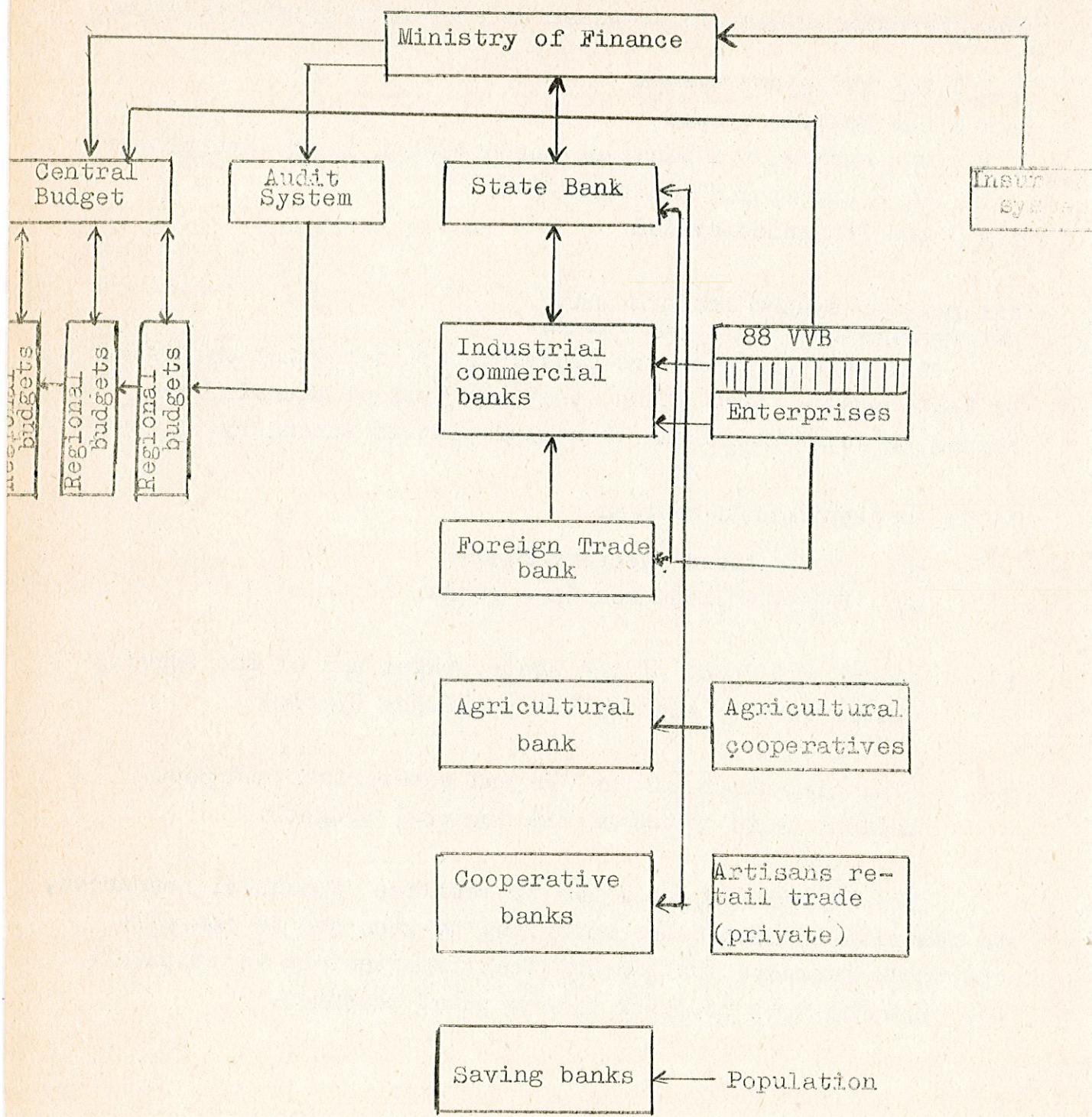
Forms of ownership (per cent of N.I.)

Year	Socialist			semi state	private
	total	nationa- lly owned	coopera- tive.		
1950	61.8	50.5	6.3	-	43.2
1968	85.1	67.7	17.4	8.6	6.3

* Semi-state ownership exists since 1953

It is of eminent importance to take the composition of social formations into consideration if we want to analyse the financial systems of the G D R, because the different social formations have different financial relations to the state budget and the other financial organs.

The Structure of the Financial System of the GDR



The financial system is composed by four main partial systems.

- (1) the budgetary system
- (2) the banking system
- (3) the system of finance of the national owned enterprises (VVB and single enterprises).
- (4) the Insurance-system.

All partial system perform unity.

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All partial plans are subordinated to the national plan of development. This means, that the physical planning is always predominant and the financial plan is secondary.

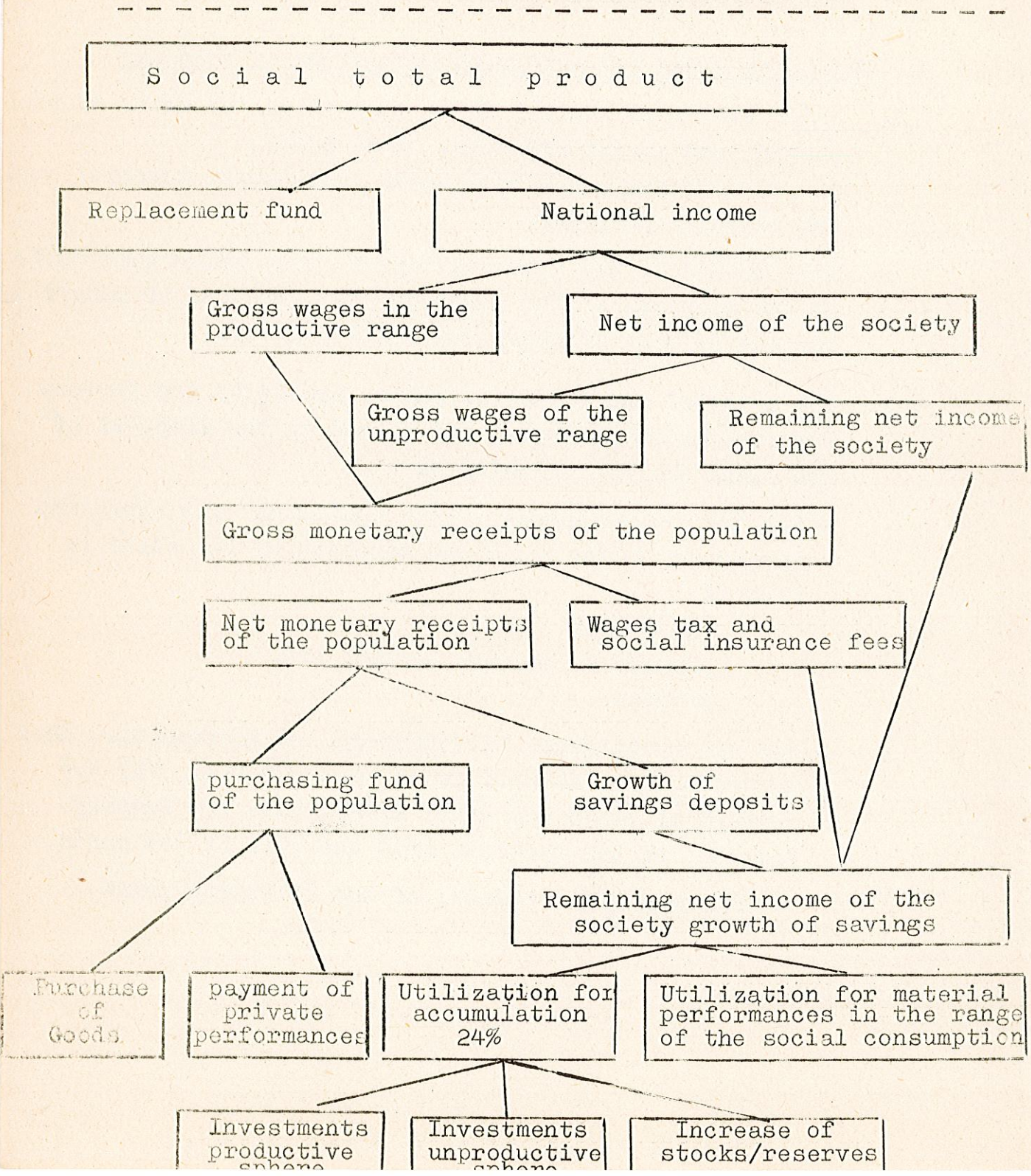
It is to distinguish between

- a) centralised monetary funds.
 - b) decentralised monetary funds.
-
- a) belong the funds of the state budget and of the banking system (partly also of the insurance system)
 - b) financial funds of the VVB and enterprises and population. Some funds of the regional budgets.

The financial system has to mobilise financial resources, to distribute these means according to plan and to control the whole reproduction process. Most important is to stimulate the productivity of labor by financial measures.

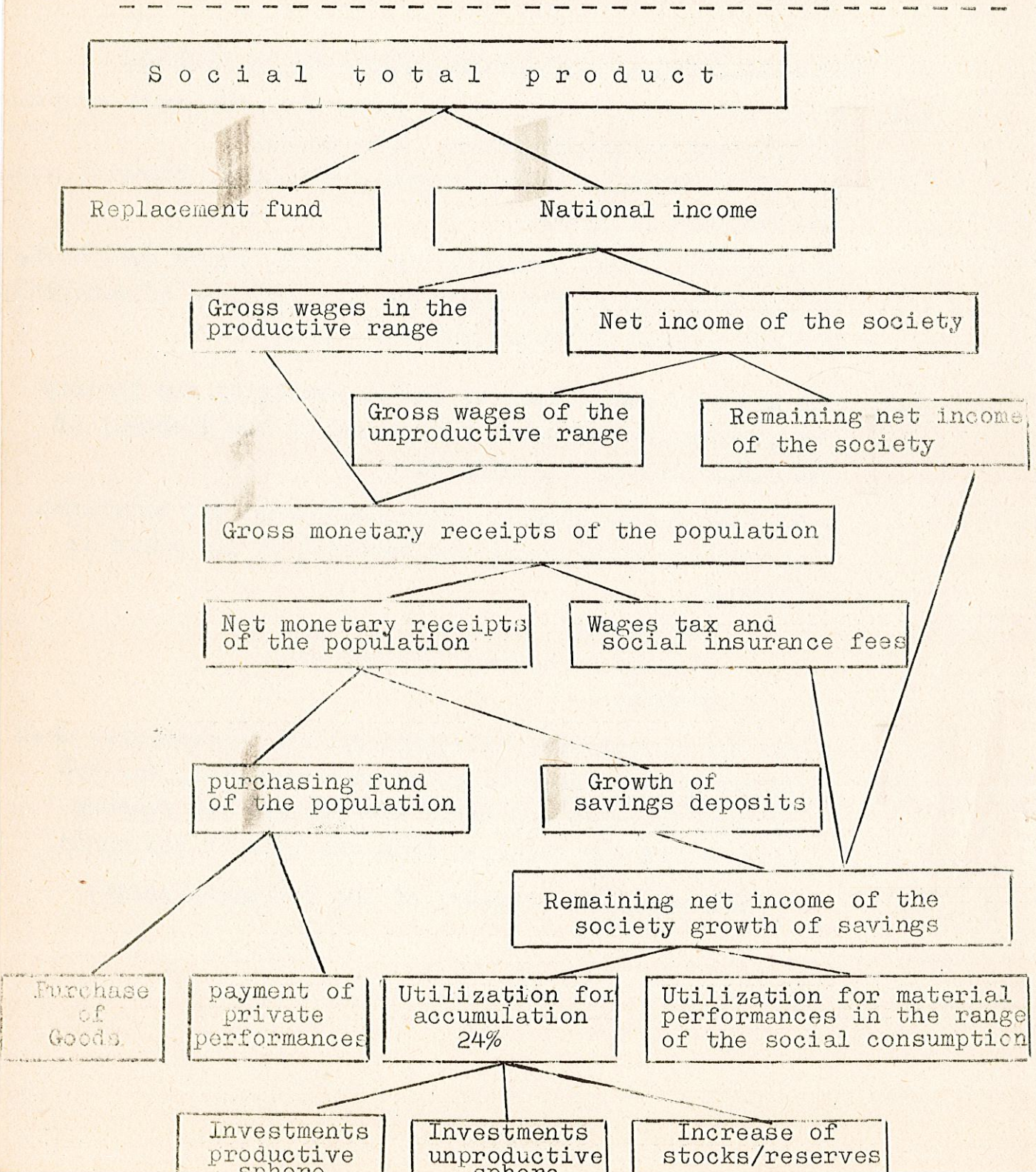
The unity and the parts of the socialist financial system
Simplified flowing picture:

Formation and utilization of the incoming
in the course of the distribution of the national income



The unity and the parts of the socialist financial system
Simplified flowing picture:

Formation and utilization of the incoming
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Depreciations

+ Consumption of material

+ Wages

+ Other costs

+ Gains

+ Stipulated payment

to state budget

} total costs

= Receipts (or: Proceeds from sale on the basis of the selling prices, valid for industrial plants).

1.3. Since the means of production are social property, the results of production are property of the society, too. That means that the parts of proceeds are to be used by the state or, respectively, on the basis of regulations, stipulated by state. In this respect, in principle, the following has to be considered:

- Parts of proceeds, serving for the replacement of used material, of paid wages and other costs, remain directly in the enterprise and are used for the continuation of production.
- Parts of proceeds, amounting to the value of depreciations and received by the plant as a replacement of worn-out machinery and facilities, are collected in a special fund. They are used for financing worn-out machinery or for financing the purchase of new machines.
- Gains and the sum, stipulated for payment to state budget are reflecting the value of the clear income which is gained by the enterprise.

These parts of proceeds are payed over to the state budget, or they are used within the enterprise according to regulations, set up by the state, or they are used by the superior body of the plant.

2. Typical Features of the Stipulated Payment to State Budget and of Gain

- 2.1. The payment to state budget is stipulated as a fixed percentage of the plant's productive funds. The rate of this payment is in average 6 % of the value of the productive found (it differ.between 1 to 8%)
- 2.2. The gain constitutes another source of revenue. It differs from the stipulated payment to state budget by its dependence on the amount of proceeds and costs whereas the stipulated payment to state budget is o n l y dependent on the amount of proceeds.

Proceeds are obtained by any sale and are realized comparatively regularly. Consequently, also the paym to state budget has to be carried out relatively regularly.

Since the g a i n is destinated by proceeds a n d costs, it is subjected to greater differences and fluctuations. Apart from that the following has to be considered:

The amount of p r o c e e d s is to a considerable extent dependent on fixed prices. Consequently, the c o s t s are subjected to greater fluctuations, since they are influenced by the enterprise more effectively. That means: Increasing costs result in reduction of gains a n d reduction of costs results in increasing gains.

If the enterprise is interested in a high gain it should primarily make efforts to reduce costs.

This interest of the enterprise in a profitable production is stimulated by the fact that the plant has a say in the distribution of gains.

3. Survey of the Most Important Financial Relations up to 1963

3.1. During the first years, following the handing-over of enterprises to the people, the gain was passed over to state budget nearly to its full amount. For this reason, the plants were only to a certain extent interested in a high gain.

Although they were allowed to use parts of the saved-up costs for additional payment of premiums to the staff, the financing of an extension of the plants (e.g. capital investment and additional current capital) was realized directly by the state budget. Consequently, the financing of this measure was not dependent on the volume of gain and its planned realization.

That is to say, the enterprise did not recognize any significant disadvantage if it worked unprofitably or did not realize the planned gain. (Please, bear in mind that such a far-reaching engagement of the state was still necessary during the first years, since the re-education of the factories' staff to a socialist way of managing economy and to socialist thinking had just begun.)

At that time existed direct financial relations between the factories and state budget. The tasks of state budget were realized by the regional departments of finance within the councils of the Regions.

The most important financial relations were the following:

3.2. Payments of the Enterprises to State Budget:

- a) Stipulated payments to state budget were to be passed over to the full amount.
- b) Gain was partly to be used for the factory itself, for the redemption of rationalization credits, for the formation of the premium fund a n d (to a certain extent) for investment and increase of current capital.

The remaining gain had to be paid over to state budget.

- c) Paying-over of current capital was realised to the full amount.
- d) Depreciations were up to 1957 completely passed over to budget (more exactly: to the German Investment Bank), which used these means for the financing of capital investment.

From 1958 on the parts of proceeds, gained by depreciations, have remained for the major part in the plants. These funds served for the financing of the replacement of worn-out machinery and facilities as well as for the financing of large-scale repairs in the factories. The depreciations, not needed by the plants for such purposes, had to be paid over to budget.

3.2.2. Payments of the State Budget to the Enterprises

The enterprises received from the state budget:

a) Payments for the Compensation of Losses

(These are carried out if the plant does not realize gain and its expenditure exceeds the proceeds.)

This compensation of losses leads among others to the fact that no enterprise, however unprofitably it is working, can go "bankrupt", if the national economy is interested in its makes. It goes without saying that nevertheless the work of such factories should be made profitable by joint efforts!)

b) Payment of Current Capital, if

- the own gain of the enterprise did not suffice and
- an increase of the required current capital by credits was not envisaged.

(The granting of such credits was determined by law. We don't want to deal with this question in this connexion).

c) Payment of Means for Investments, if

- the own means of the enterprise for depreciations and
 - the own gain of the enterprise
- did not suffice for financing the envisaged investment measures.

3.3. These direct financial relations of the plants to the regional budgets were difficult to survey which resulted in a loss of control over the development of industrial production by the aid of monetary intercourse.

Consequently a great number of enterprises of different branches was linked with the budgets of more than 200 regions by regional aspects.

For this reason, it was extremely difficult to analyze and influence the production by the evaluation of financial target figures (e.g. of the monetary intercourse between enterprise and budget).

Each region had financial relations with enterprises of most different branches and capacities. Therefore, the staffs of the financial departments were not able to obtain a clear picture of the numerous special features of the differing branches.

Since 1964 these difficulties have been overcome to a great extent by the introduction of the new economic system of planning and managing national economy.

4. Survey of the Most Important Financial Relations since 1964

The Associations of Nationally Owned Enterprises (VVB) developed to managing organs of economy. They are in each case responsible for the subordinate enterprises of one branch.

The former direct financial relations between enterprise and budget were replaced by the relations

enterprise → VVB → State budget.

4.1. The principal financial relations existing since 1964, are:

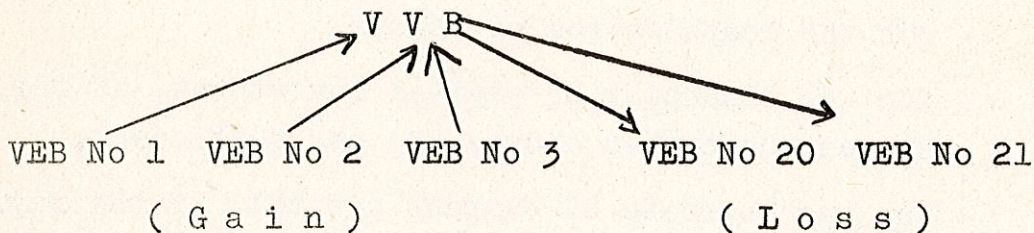
a) The stipulated payments to state budget are passed over from the enterprises to the VVB. The VVB transfers these payments in the full amount to state budget.

(Since the payment to state budget depends on the turn-over, the VVB can control the development of turnover in the given branch of industry of means of this payment.)

b) The gain(which is not utilized in the factory) is not any longer paid over to state budget directly but to the VVB.

The VVB utilizes this gain for the compensation of possible losses in other plants.

Sketch:



By this re-distribution the VVB is able to exercise influence on the profitableness of the plants within its branch of industry and to control them.

If, however, the enterprises had to pass over all of the gain, they would not be sufficiently interested in a high gain. A reduction of gain or a non-realization of planned gain would bring more difficulties for the VVB than for the plant.

That is why the enterprises must be interested in a high gain, being in accordance with the plan. For this reason, considerable parts of gain are utilized in the factory.

- for the redemption of rationalization credits,
- for the financing of planned investments, as far as the own funds do not suffice for amortizations,
- for the increase of own current capital, as far as this is planned.

Only if parts of gain remained after utilization for these purposes the remaining gain is passed over to the VVB. If the gain of the plant is not sufficient for covering the mentioned tasks, the factory receives appropriate payments from the VVB.

Consequently the VVB utilizes the gains, passed over to it,

- for the compensation of losses,
- for the financing of capital investment, as far as the source, described above, are not sufficient,
- for the increase of current capital, if the payments of current capital from other enterprises do not suffice (after re-distribution by the VVB).
- The remaining parts of gain are to be passed over to the central state budget by the VVB.

If the gains, passed over to the VVB, are not sufficient for the coverage of the mentioned tasks, the VVB gets appropriate payments from the state budget. or they get credits from the banking system.

- 4.2. - The re-distribution of depreciation, passed over to the VVB, and
- the re-distribution of current capital, passed over to the VVB. is organised as follows:

- a) Parts of depreciations are payed over to the VVB by the factories if they are not required for the financing of own investments.

The VVB re-distributes the obtained depreciation among other factories, the depreciations and gains of which do not suffice for the coverage of their investments.

If the VVB after this re-distribution disposes of remaining parts of depreciations, these have to be passed over to the state budget for the central re-distribution.

- b) The payments of current capital are carried out to the VVB. It utilizes these means for the planned payment of current capital to other factories of the branch of industry, concerned.

Parts of this current capital, which are not needed for re-distribution, have to be passed over to state budget by the VVB.

- 4.3. The principle of financing research and construction tasks.

For these purposes the enterprises are passing over fixed amounts of money to the VVB each month. The VVB is collecting these means in the so-called "Fund for Technology"

From this fund for technology the enterprises and institutes, dealing with research work, receive the expenditures after realization of their measures. This method is used out of technical reasons, being connected with accountancy,

which are not subject of detailed consideration within the framework of our topic.

5. Conclusion

Undoubtedly, you recognized that the present regulation of financial relations between enterprise and VVB constitutes an interlaced system, appearing rather complicated. It is complicated because it reflects a great variety of significant economic features, being concentrated, but consciously included in this system. By handing over the function of re-distribution to the VVB these should be enabled to recognize the most important economic features in their subordinate enterprises.

Thus they dispose, at the same time, of the economic means, required by them to exercise decisive influence on the work and development of the enterprises.

The following example is useful to make clear this mechanism of operations (Between enterprises and the VVB or the state budget respective)

a) Plan (The enterprise has a production fund of 10, Mio Marks)

Gross profit	1600 TM	
- <u>Production-funds-duty</u>	<u>600 TM</u>	(= 6% of 10 Mio Mark)
Net profit	1000 TM	
- <u>delivery of the net profit</u>	<u>500 TM</u>	(= 50% of 1000 TM)
Remaining net profit in the enterprise:	<u>500 TM</u>	

This planned net profit in the height of 500 TM is to be used as follows:-

Supply to the investment fund	250 TM
Increase of the current funds	50 TM
Supply to the bonus fund	180 TM
Repayment of credits	20 TM
	<u>500 TM</u>

b) Actual fulfilment (underfulfilment)

Cross profit	1500	(on behalf of deficient
- Production-funds-duty	<u>600</u>	utilization of the production
Net profit	900	funds the planned profit
- delivery of the net		in the height of 1.600 had
profit	<u>500</u>	not been obtained)
remaining net profit		(although, the created net
in the enterprise	400	profit is by 100 lower than
		the planned one, the delivery
		of the net profit has to be
		effected according to the
		planned height.)

As the in the enterprise remaining net profit is by 100 lower than being planned, thus, 400 instead of 500 are only allowed to be transferred to the funds of the enterprise,

e.g., :-

Supply to the investment fund	240
increase of the current funds	40
Supply to the bonus fund	100
Repayment of credits	20
	<u>400</u>

c) Actual fulfilment (overfulfilment)

Gross profit	1800	(owing to good utilization
- production-funds-duty	600	of the production funds)
Net profit	<u>1200</u>	
- delivery of the net profit	640	(500 planned deliver of the net profit +70% of the exceeding amount of 200)
remaining net profit of the enterprise	<u>560</u>	(500 planned + 30% of the exceeding amount of 200)

On behalf of the overfulfilment of the in the enterprise remaining net profit by 60 (planned 500, actual fulfilment 560), the enterprise is allowed to increase the supplies to the funds of the enterprise by 60:-

e.g.:- Supply to the investment fund	270
Increase of the current funds	60
Supply to the bonus fund	210
Repayment of credits	20
	<u>560</u>

d) Actual fulfilment(outbidding of the state proposal given)

Gross profit	1.800	
- production-funds-duty	600	
net profit	<u>1.200</u>	
- delivery of the net profit	580	(500 planned + 40% of the outbidding amount of 200)
remaining net profit in the enterprise	<u>620</u>	(500 planned + 60% of the outbidding amount of 200)

Now, e.g. the enterprise is allowed to increase the supplies to the funds of the enterprise as follows:-

Supply to the investment fund	280
Increase of the current funds	70
Supply to the bonus fund	250
Repayment of credits	20
	<hr/>
	620
	<hr/>

That example of figures shows in what way the long-term normatives production-funds-duty, net profit, delivery of the net profit, and bonus fund estimate the conformity of the interests of the enterprise and the personal material interests with the whole-social requirements.

Hence it follows:-

- a) The higher the net profits of the enterprises the greater is the growth in the national income. Therefore, high net profits correspond not only to the interests of the enterprises but also to the whole-social requirements. As the supply to the bonus fund depends on the height of the created net profit, thus, a high net profit corresponds directly with the workers' personal material interests, too.
- b) If the planned net profit is going to be overfulfilled, thus there also will be a higher growth in the national income, greater possibilities concerning the extension and rationalization of the production in the enterprise, and higher supplies to the bonus fund.

What there is useful for the whole society (a maximum growth in the national income) provides to the enterprise (more investment) and the single worker (higher

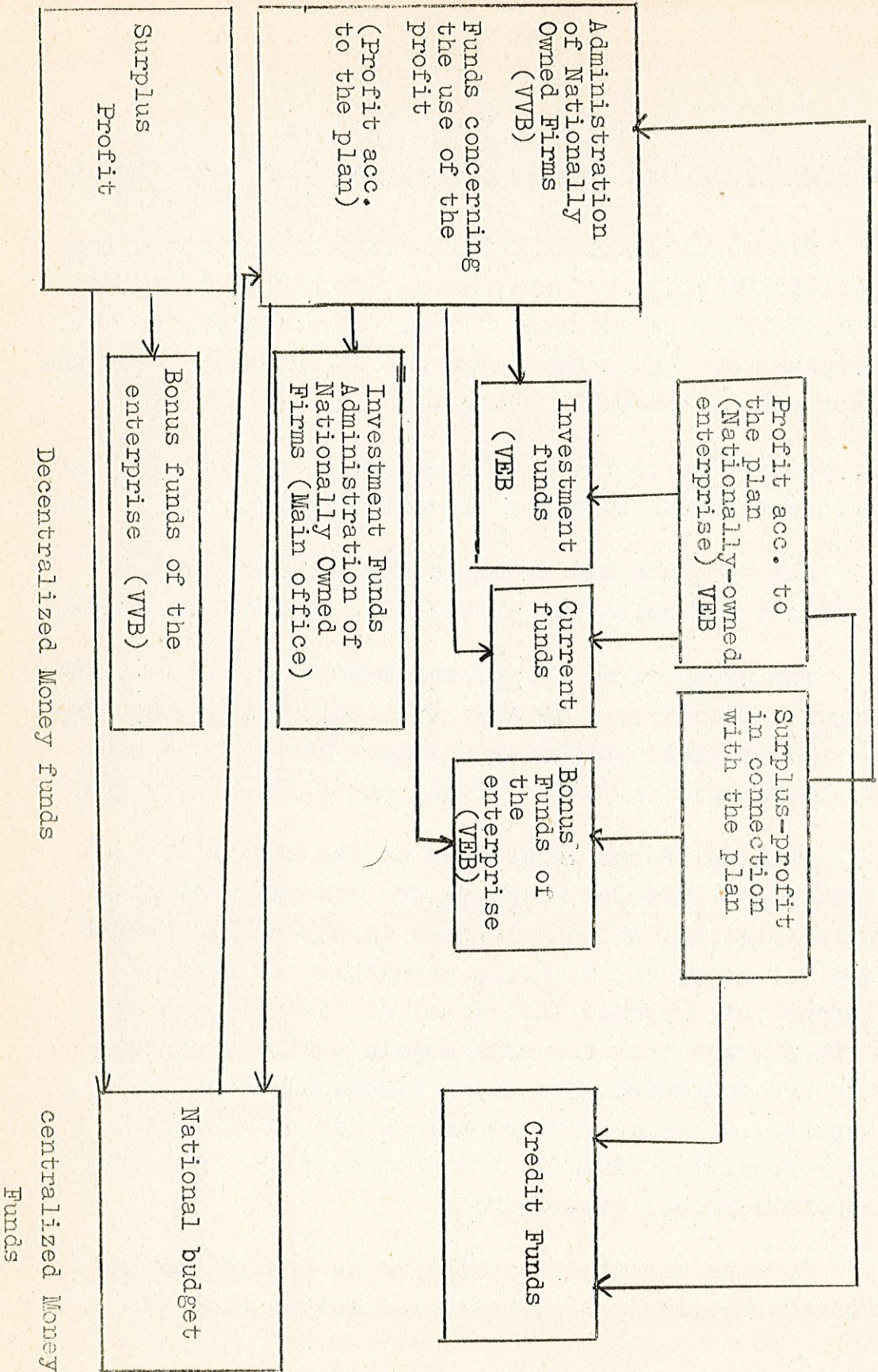
bonuses) material advantages, too.

- c) The advantages for the enterprises and the single workers are going to be the highest, if the state proposal given for the net profit will be outbidden.

In this case the supplies to the funds of the enterprises (including the supplies to the bonus fund) are higher than in the case of overfulfilment of a net profit based on the state proposal given.

According to the before-mentioned statements one easily may find out what about the importance of the correct utilization of the economic categories price, profit, finances etc. for the correlations between central state management and the socialist goods producers.

Flow of financial means from national owned enterprises to the state Budget and between VVB and enterprises



2. Money relations of public institutions (culture, health and education)

Financial means of public institutions operating in the fields of cultural activities, education, health and social services are generated and applied according to the budgeting method. The money relations of these institutions are components of the public budget.

Connection to the public budget is established according to the so-called gross financing principle.

All receipts and expenses are included in the budget without any balancing of one side against the other.

The proportion of expenses exceeding the institution's self-earned income is made available out of the competent super-ordinate authority's budget by way of a bank account established in favour of the institution involved.

Principles and objectives of the socialist economic system are intended to stimulate economic thinking also in institutions whose relations to the public budget are based on the gross financing principle, so that as many elements of economic efficiency as possible are applied. This means that the expense-gain-ratio is expressly to be considered when these financial means are being applied, so that expenses are as far as possible covered by receipts earned in the course of the institution's operations and performance.

In this way the financial means applied in the institutions exercise a stimulating effect so that the

means provided are used more efficiently and performances are extended and improved.

The suitable way of achieving this objective is the transition to performance-dependent financing.

Gross financing as used up to now provides the financial means for expenses out of the public budget without any consideration of planned receipts being earned and actual performance.

Whenever performance and receipts are not up to expectations financial compensation is paid by the super-ordinate public authority - at the expense of society.

On the other hand, surplus receipts due to increased performance and genuine savings in planned expenses are not immediately shared by the institution and its staff.

<u>Example:</u>		<u>E</u>	<u>A</u>		<u>E</u>	<u>A</u>
(A)	P	100	300	(B)	100	300
	I	70	290		120	305

whereas

E = receipts

A = expenses

P = planned

I = actual

When the gross financing principle is applied there is no immediate personal (i.e. incentive-based) interest in the financial result.

Institutions operating in the cultural and social sphere are therefore encouraged to switch to performance-dependent financing.

Development and application of performance-dependent financing.

Development and application of performance-dependent forms of financing result in

- increased responsibility of the institution itself for generating and applying their financial means, and
- more efficient use of financial means as stimulant for improvements in performance.

Example: Planned subsidy for an institution is made dependent on performance expressed in receipts; in view of the ratio applied the year before and in consideration of expected improvements the subsidy is continued at 200 per cent, i.e. at a ratio of M 2 provided for every M 1 earned.

		<u>Planned data</u>	<u>Actual data</u>			
			var.	1	2	3
Receipts	M	500		400	500	600
subsidy out of budget	M	1,000		800	1,000	1,000
(planned data = max. actual data)	M	1,500		1,200	1,400	1,400
surplus		0		0	100	200

When a subsidy required to provide for expenses is made dependent on certain performance criteria, e.g. the number of visitors attending cultural institutions per year or the amount of receipts compared to planned data, the following stimulative effects are released:

- Institutions are given a material incentive to obtain the planned level of receipts, since planned subsidy is available only in this case; if the condition laid down is not met then they are bound to reduce expenses that would not be covered.
- Institutions are given a material incentive to achieve surplus receipts and make savings since they may, if they may, if they do not claim the planned subsidy,
 - . add up to 44 per cent to their bonus fund, and
 - . use 25 per cent to finance additional activities or objects, e.g. improve working conditions, in their own responsibility.
- Superordinate authorities, too, are given a material incentive, when this form of financing is applied, to assist subordinate institutions in their efforts of improving efficiency. Local public authorities may add their share of savings made by subordinate institutions to the reserve fund administered by the representative body (i.e. the local council or assembly) involved,

The new ways of financing result in an interrelation of individual, collective and social overall interests that is far more efficient than the outdated way of gross financing.

Available experience shows that the utilization of funds and the services provided for society have improved in the course of performance-dependent financing, e.g.

- the number of visitors attending theatres, museums, civic centres, etc. has increased, the number of events and the receipts earned have risen so that subsidies out of the public budget could be reduced (without the quality of the services involved being lowered).
- Civic centres operating on the principle of performance-dependent financing require an average subsidy of M 170 per M 100 of receipts earned, i.e. 170 per cent. In contrast, the expenses of civic centres applying gross financing exceed their receipts by more than 230 per cent, on the average.

At present, performance-dependent financing is not yet dominant in institutions operating in the sphere of social consumption.

The principal problem that must be solved to apply this new way of financing on the basis of the budgeting method is to define economic criteria that are accurately measurable and assessing actual performance, so that subsidies can be calculated and the material (i.e. incentive-based) interests of the institution and its staff can be fully brought into line with the necessities of planned social overall progress.

In those institutions, where immediate dependence of budget subsidy upon performance is not or not yet feasible, the point is to economize management by improving book-keeping considering expense and gain. This way

of accounting encourages the application of suitable methods of measuring and assessing the gain and improving the expense-gain-ratio, i.e. obtain planned gain at less expense, or higher performance at planned expense.

Summary

Finance as applied to public institutions must be developed and set up according to the basic idea in the economic system and in view of the corresponding decisions taken by the GDR State Council so that work and efficiency of the institutions involved are more and more influenced by economic considerations.

The modern way of financing the institutions operating in the cultural and social sphere is performance-dependent financing, because it corresponds best to the congruence of interests comprising society, institution and staff, effectively encourages thinking in terms of the expense-gain-ratio, and stimulates efforts directed at mobilizing existing reserves for improved performance and enforcing appropriate economies. The stimulative role of performance-dependent ways of financing is based on the resulting increased effect of material incentives provided.

Application of these new ways of financing must not lead to a reduction or deterioration of services provided by the institution due to economies applied in the wrong place and contradicting social overall interests.

Stimulation by financial means is intended to improve extent and quality of services provided for the population and encourage the use of state subsidies at increased efficiency.

This principal orientation towards increased efficiency of financial means by improved utilization of their functions

- especially in view of their significance as material incentives acting as economic levers - applies also to institutions operating in other spheres of social consumption.

3. Example remarks on receipts and expenses of the public budget

In order to discharge its functions the socialist state requires extensive money funds, whose volume keeps growing due to social progress and the increasing dimensions of the objects to be financed.

The public budget is the most important public money fund.

Its sources of receipts, its volume and application are annually defined in the public budget plan on the basis of the national economy plan, and the budget is then placed before and approved by the People's Chamber, the GDR parliament.

Term: The public budget represents the system of money funds existing with the public authorities; they are established according to planned objectives on the basis of money relations to all spheres of national economy and the population, and they are

distributed and applied according to the plan governing the reproducing process in national economy.

Functions of the public budget

- (1) Mobilization and centralization of pecuniary resources required to cover the public funds according to the requirements stated in the national economy plan, using the budgeting method (i.e. no repayment of funds is required).
- (2) Distribution of pecuniary resources to both central and local public authorities and the enterprises and institutions they are in charge of, to finance the planned political, economic, cultural, social and military activities and objectives according to competencies involved.
- (3) Stimulation and checking of all-round execution of planned activities aimed at obtaining maximum efficiency in national economy.
- (4) Contribution towards ensuring stability of state finances and currency.

The public budget is a political and economic controlling instrument of the state. Proceeding from prognoses and in full agreement with perspective planning as well as the national economy annual plan, the public budget serves to facilitate and control the planned social reproducing process in terms of money. It plays an essential part in converting the socially available share of the social overall product and the national income into the planned socially applicable share.

The objective economic functions of socialist finance are used for that purpose. The public budget exercises its distributing function, its stimulative function and its checking function by a differentiated system of budget relations to all spheres and branches in national economy, to enterprises of all forms of ownership, to public authorities and institutions and the population as well as to other components of the financial system. National income is redistributed by differentiated budget receipts and expenses in four principal directions, i.e.

- (1) from the productive sphere to the non-material sphere of national economy;
- (2) within the productive sphere among the various branches;
- (3) regionally among the territorial units; and
- (4) among the economic forms, classes and social strata existing in the population.

Financing of expenditure that is objectively necessary in the interest of society as a whole but cannot be provided by the enterprise or industry involved without outside help is bound to require a final redistribution of national income, which is effected by way of the public budget.

The financial requirements of the state, which are to be met by way of the public budget, are to be brought in line, - in the interest of a coordinated effect, within the framework of the economic system, of finance as a whole, and - to ensure stability of state finances and currency, with . planned and systematic development of efficiency in national economy,

- financial requirements of spheres and branches,
- development of the credit fund,
 - the insurance fund,
 - money circulation, and
 - money income and expenditure of the population.

Main source of public budget receipts are contributions out of the net income of nationally-owned enterprises and institutions, especially by way of

- 1) production fund imposts,
- 2) net profit levies,

In the 1969 budget they correspond to M 35 billion (about 54 per cent of total receipts).

Further public budget receipts are provided by

- taxes and consumption levies,
- profit shares from state partnerships,
- contributions to the social insurance system paid by workers and salaried employees,
- charges and fees, fines, rents,
- income earned by public institutions,
- income from price differences and surplus profits.

Financial means required by nationally-owned enterprises or industries take pride of place among public budget expenses. They are made available for

- investments whose financing by way of the budget has been decided by the Council of Ministers;

- temporary support of prices for special products;
- measures to raise productivity and reduce costs in agriculture and the foodstuff industry.

(such as specialization, concentration, melioration, bonuses for increased production rates, extra prices paid to producers, and other measures stimulating production).

Substantial financial means are also provided by the public budget for

- education, physical training, sports (about M 5 billion);
- cultural activities (including communications) (M 1 billion);
- health and social services (M 5.6 billion).

Investments to replace and extend prime funds at public institutions are also financed out of the central budget to the extent of about 55 per cent.

Not quite 10 per cent of the expenses volume (9.77 per cent = M 6,350 million) are used for defence and security.

A particularly large proportion of expenses is provided to meet the obligations of the social insurance system.

To cover expenses, which substantially exceed receipts, of the social insurance system (M 3.8 billion for obligations involving workers and salaried employees; M 1.15 billion for people voluntarily subscribing to the insurance company (DVA); referring to the 1969 budget).

The system of taxation
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A standard taxation system does not exist in the GDR
Taxes are paid only by the following social formations :

- (1) Taxation of workers, office workers and intelligentsia of the private sector.
- (2) Taxation of private crafts man.
- (3) Taxation of private economy.
- (4) Taxation of the Agricultural Production cooperatives and their members.
- (5) Taxation of crafts-Productive cooperatives and their members.
- (6) Taxation of semi-State enterprises.
- (7) Taxation of traders working on commission contracts.

- 1 - Taxation in group 1 is limited to 20% (progression from 0 to 20%).
- 2 - Private craftsman pay a standard tax (if they don't employ more than three workers).
- 3 - Private entertainers pay income and other taxes up to a progression to 90%.
- 4 - Cooperatives pay no taxes .

- 5 - Members are patronised in taxation.
- 6 - Semi state enterprises are parionised in taxation. Special taxes, which are very favorable for the entertainers in semi-state enterprises give them wide advantages in comparision with full private enterprises.
- 7 - Private traders working on commission contracts with state owned trading companies pay only taxes like workers (20%)

The system of taxation supports the transformation to socialist ownership (cooperatives and semi-state enterprises).

4. Credit in the Financial System

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Credit will be granted to productive enterprises and traders, transport enterprises of all social formations in accordance with their plans. Additional credits can be granted if the enterprises are able to ~~additional~~ additional production over the plan and if there are difficulties in plan-production. In this case they are underthrown to special conditions.

Credit has to ensure the financem~~ent~~ of planed pro-
duction on the basis of planed costs and gains. It has to
stimulate the increase of productivity of labour by dif-
ferent measures.

In the new economic system the enterprises in gen-
eral have to fiance their investments by own financial
means and funds, using credits in addition to these means.

The enterprises have to sign credit contracts with
the banks in which all conditions (interests, repayment,
sanctions) are inclosed.

If the enterprises don't repay the credits or arnt'
able to pay interests and so on, the VVB is resposible to
cover all losses and to take measures that the enterprise
will be reorganised if necessary.

Balance of the Credit System

(~~31.~~ 12, 1967)

in Mrd. Marks

Investment credits (productive)	15.6	Assets of enterprises and organisations	21.0
Construction houses	16.7	Savings (private)	44.7
Stocks of wares (in production and trade)	47.6	Issue of money	5.9
Credit to private persons	1.0	Others	9.3
Total	80.9		80.9

5. The System of Money-Circulation
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In the GDR money can only be issued by the state bank. The other banks dispose only in their own monetary funds and assets of enterprises and state or other organisations.

The state-bank is refinancing the other banks if necessary.

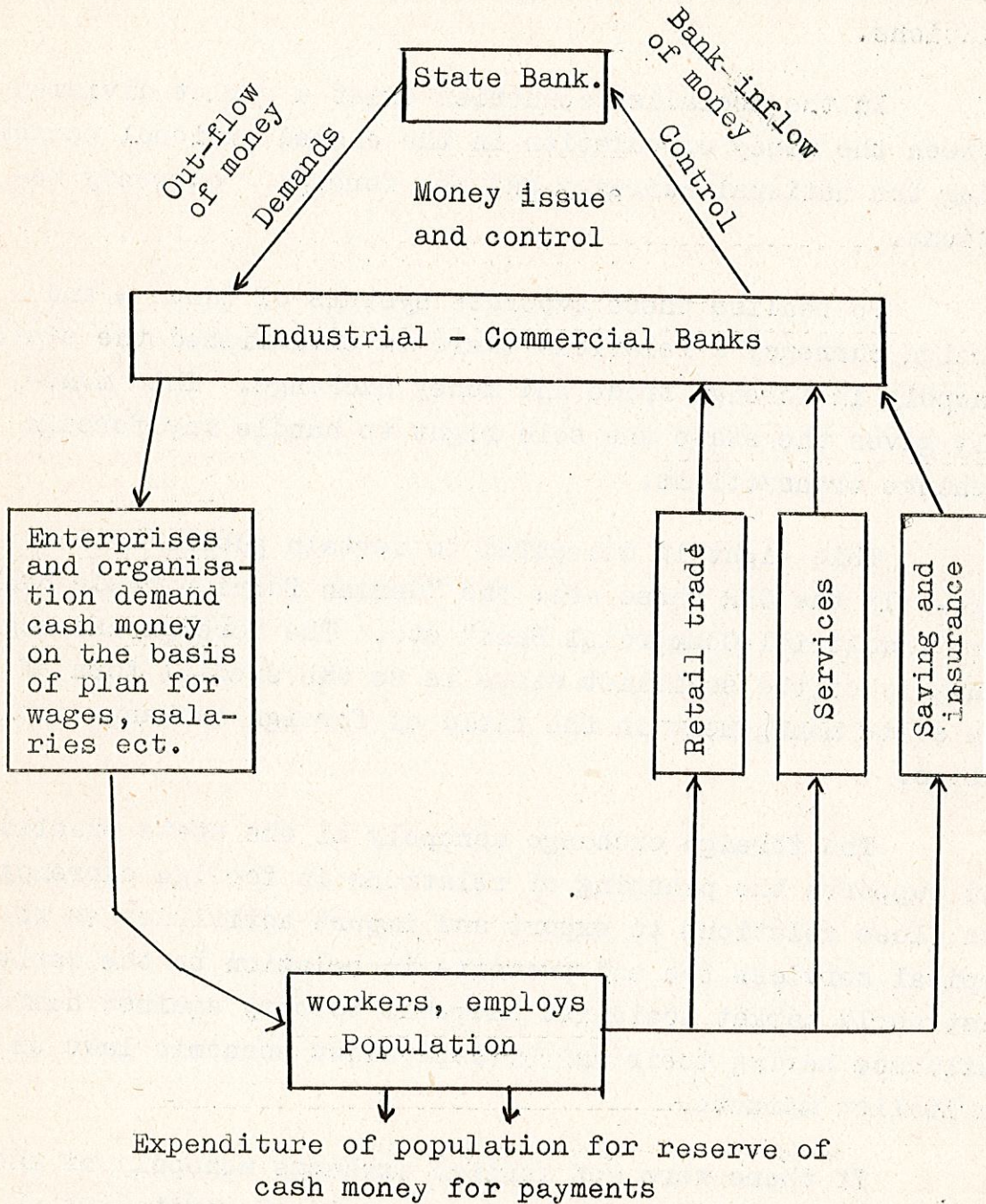
The circulation of book-money (Giro) is planned and controlled by the credit-plan.

The issue of bank-notes and coins is managed by a special plan.

Both plans (credit and cash money) are closely connected with the financial and physical planning of enterprises, state organs and other public organisations.

By this way credit recourses and credit demands are balanced in before. Extension of money only is allowed, if the increase of production makes it necessary.

Circulation of cash-money



Foreign currency relations:

Foreign currency relations have their origin in many-fold activities of the state enterprises and private monetary relations.

In the socialist countries exist a strict division between the money circulation in the closed national economy using the national currency and the foreign = currency relations.

To realise these separate systems of inner = and foreign currency = relations there is established the state monopoly in foreign trade and money exchange. This monopoly gives the state the sole right to handle any foreign exchange transactions.

This right is delegated to certain public authorities. In the GDR these are: the "German Foreign Trade Bank" the "Industrial-Commercial Bank" etc. The foreign exchange monopoly of the socialist state is so the special form of the state management in the field of foreign exchange activities.

The foreign exchange monopoly of the state enables and supports the planning of relations in foreign currency and its close relations to export and import activities as to capital services too and protects in relation to the capitalist world market socialist national economy against harmful influence having their origin capitalist economic laws on the capitalist markets.

If there were no foreign exchange monopoly of the socialist state, the effects for example of capitalist currency crisis would reach right into the interior markets of socialist countries. As far as socialist countries are

The balance of trade is divided into:

Balance of trade with foreign countries/in total/
 Balance of trade with single countries
 Balance of liabilities and assets in foreign currency
 total
 different currencies/socialist countries/ ca-
 pitalist countries

Balance of capital services in total and to different
 countries

Balance of payments; total summery and divided into:
 with socialist countries
 with capitalist countries
 in hard currency
 in clearing currency

Planning of foreign currency relations and transfer is
 always closely connected with the other partial systems of
 planning as for example:

Planning of production and distribution of production
 Planning of the financial system and others

So planning of foreign currency relations is part of the
 comprehensive system of planning in socialism and can only
 be effective and realised if the partial systems are harmo-
 nised with all other partial planning systems.

concerned the foreign exchange state monopoly directs foreign exchange activities in such a way that all partners participating derive optimum benefit from them. This applies equally to trading activities with capitalist countries as far as they are engaged in carrying out peaceful trade on the basis of mutual respect for sovereignty and mutual benefit. Additional foreign exchange earnings proceeding from the concentration of foreign exchange activities in the hands of the socialist state authorities increase the import potentials and contribute to the growth of the national income. A precondition is, that the national costs of production of goods for exportation are not higher than the average costs of the world standard.

Of great importance is the planning of foreign currency relations. Instruments in this regard are:

i/Balance of trade and payments

It is obvious that socialist countries must in any case avoid to get into a debtors position in relation to capitalist countries on account of a passive balance of payment.

Such a situation can be used by capitalist countries to pressure the debtor countries and to get political and economic concessions.

So the GDR - balance of payment is usually offset. Any temporary credit balance is of course not due to the aim of gaining a creditor's position in relation to the country concerned by temporary assistance given to allied or developing countries. There may be also other reasons for it. For instance the inability of one country to fulfill the positions in trade agreements and so on.

7. Pricing in the Economic System of Socialism

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The prices of commodities are the monetary expression of the value of products or services. They should reflect, precisely and uniformly, the social outlays in, and results of production. They must exactly show the cost society has to bear in satisfying its requirements. Only on this condition the price system can provide exact economic measures to make it possible to choose the optimum goods and trends of technological progress, and to take the most rational decisions in planning, designing, and management.

In the economic system of socialism the price connects the social demand with the material interests of the working teams and the individual in manifold ways. It is an important link between central state planning and the economic self-responsibility of the enterprises and the associations of nationally -owned firms.

In 1963 a new economic system was introduced in the GDR. In connection with the evaluation of the productive assets, a new fixing of the depreciation rates, and other measures developing a uniform system of economic incentives, the industrial price reform was a decisive prerequisite for smooth functioning of the economic system.

Before this price reform current prices were partly derived from the level of before 1945. These old prices did not cover the necessary costs of production and others. Above all the prices of money goods of the basic industry were below the socially necessary prime cost. High price subventions were paused by the state. The price did not give a correct picture of the real prime costs and performances of the enterprises. In some cases the old prices delayed the introduction of measures of the scientific-technological revolution and caused misdirected investments. Furthermore these old prices retarded the full application of the principle of material interestedness. Therefore it was necessary to include a reform of the system of industrial prices in this new economic system.

The industrial price reform led to an alteration of some prices for goods and services in industry, building, and transport. In the sphere of production and transfer prices (between production and foreign trade) were affected. The prices of consumer goods were not changed. The price reform took place in three stages from 1964 to 1967.

The price system of the means of production was newly fixed. Fundamentals for this were - among others - the following principles:

Firstly, pricing according to the socially necessary outlays and suspension of price subventions, as far as possible. Corresponding to this the industrial price of a commodity had to be fixed in such a way

- * that enterprises, on a normal level, could produce that commodity on the level of the socially necessary prime cost and
- * a profit could be achieved which, as a rule, enables the association of nationally-owned firms to finance the expanded reproduction of its enterprises.

Secondly, the prices had to be fixed as an economic incentive to induce the production of goods with high quality and lowest prime cost. For this purpose the following measures were carried out:

- * The calculation of profit was changed. Not the whole prime costs, but only the conversion costs (processing costs) form the basis for the calculation of profit.
- * For commodities of the same kind and quality uniform prices were fixed.
- * The prices of the commodities were fixed according to their quality (additional charge according to the grade labeling) and their use-value (economic-technological parameters) and whether the goods were standardized or not.

At the same time pricing with the help of these principles became a decisive prerequisite to complete the functions of the profit as a measure of the performance of the enterprises as well as an economic incentive. With the changing of prices according to these principles the changing of costs, profits, values of the stocks, and of resources of the fund financing was connected.

Within the first and the second stage of this price reform the total sum of all industrial prices increase especially caused by measures in the basic industry - by about 50 per cent and within the third stage about 4 per cent. These price increases were partly compensated by the omission of the production fund levy. In 1965 the value of the social total product increased by about 19 thousand million marks and the value of the national income lost about 4,000 million marks. The total sum of price subventions could be reduced from 13.5 to about 7.5 thousand million marks.¹⁾ The essential part of the remaining price subventions are necessary for the unchanged prices of consumer goods.

The consequences of the industrial price reform forced the enterprises to operate still more economically. An example may illustrate this. In spite of the increase of the industrial production in 1965 the new prices led to a reduction of the consumption of solid fuel within the industry of about 6 million tons compared with 1964. The industrial price reform stimulated in various ways the saving of material, energy, semi-finished products, etc. The position of the industrial price of goods within the economic system of socialism is shown in a table.

1) Cf. Autorenkollektiv, Wirtschaftliche Rechnungsführung und Kostenrechnung, Berlin 1968, pp. 129/130.

Some Remarks on a Revisionist Opinion

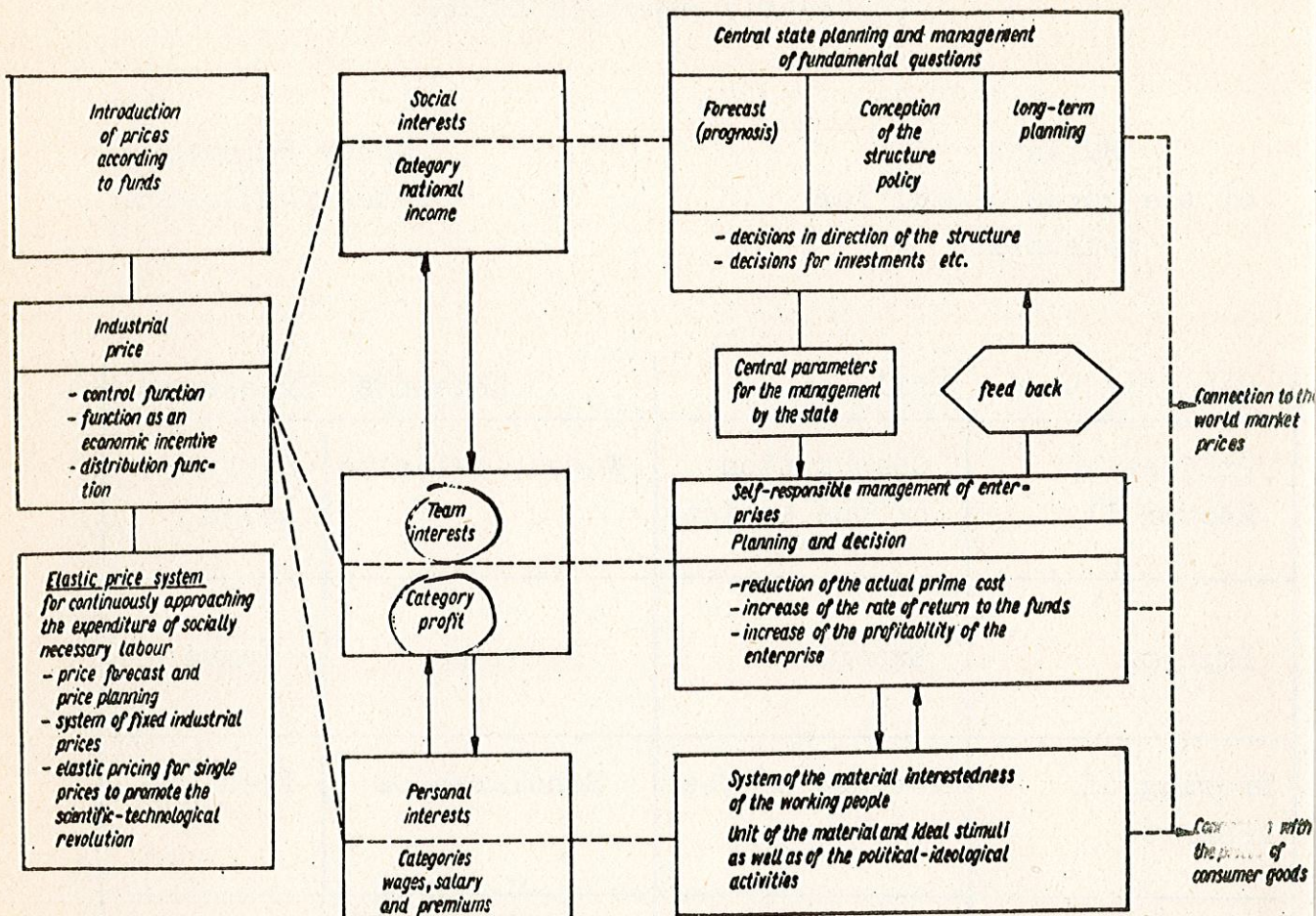
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Since in the GDR the plan and not the market is the decisive instrument of management of the national economy, we don't speak of a "socialist market economy" but of a socialist planned economy.

Certain revisionists of Marxism and Leninism assert that only the utilization of the market permits planning on a scientific level, because only the market is a real basis for objective criteria of planning. This thesis opposes the character of socialism. It undermines its fundamentals and its advantages and in reality serves the aims of the enemies of socialism.

The social requirements are more fundamental and more comprehensive than the requirements of the market. Therefore not only the market determines the economic criteria for the plan. Production has always priority in all economic spheres. Decisive effects come from the production sphere beginning with research and design in order to promote demand and market. This development and likewise the trends of science and engineering as well as the development of the structure of the national economy cannot be covered by a forecast of the market. Only on the basis of forecast and planning on the scale of the whole national economy and the requirements of the scientific technological revolution it is possible to direct research and design, investments and other essential components to the future tasks.

It is obvious that the market cannot fulfil these aims. For this reason the main orientation to the market would mean a lagging behind of the planned socialist economy. This would result in enormous economic losses and back-wardness in the fields of science and engineering. In addition to that the planned and co-ordinated development of the other social subsystems, for instance the system of education and training, would become impossible.



Model of the Industrial Price of Goods
 Within the Economic System of
 Socialism

The Planning of the Consumers Prices

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 (Schematic representation)

Balance
 of the goods useful for
 consumption

Money Balance
 of the population

Balance of the goods useful for consumption		Money Balance of the population	
Goods in hand	Utilization	Receipts	Expenses
Production Sector II	Consumption of the society	Wages, Salaries	Performances
Imports	Export	Pensions	Taxes
Drawing of Reserves	Increase of the reserves	Scholarships	Feés etc.
	Goods being useful for the population	Drawings from the Savings Bank etc.	Purchase of goods (Retail trade business)

Price Plan concerning
 the consumers prices

Total of the retail prices concerning the goods being useful for the population	Purchase Funds of the population
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