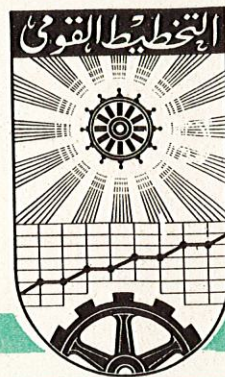


UNITED ARAB REPUBLIC

THE INSTITUTE OF NATIONAL PLANNING



Memo. No. 1030

Socialist Finance
(Basic Problems of the Theory
and Practice of Finance in Poland)

By

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Feb. 1973

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1 . Introduction:

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1.1 General Outlook:

Finance is still a relatively new intellectual discipline which its theory is, in fact, a vast and disorderly area of economic thought, both in capitalist and socialist literature. This is due to the fact that there is still a lack of well defined theory in the finance field, and consequently there is no agreement on the scope and range to be encompassed by the theory of finance. (*)

In recent years, the studies in finance, in the socialist economy exhibited important new directions, dimensions and significance of the problem. This stems from the agreement between, almost, all socialist writers about the objective necessity and importance of commodity money relations and value categories in the practices of the socialist economy. This theoretical trend has been practically justified by the economic

(*) It is particularly in socialism, the theory of finance has suffered, as other disciplines of its political economy, from the dogmatic ideology of the apologetic trend in the political economy of socialism. The cardinal issue of this trend was, simply, the idea that the socialist economy must not be a commodity-money economy, and consequently the categories of the law of value do not operate in it. For detail, refer to:

A. El-Sharkawi, The System of Financial Flows Tables in a Socialist Economy (Basic Problems of the Theory and Application of Finance, with special reference to People's Republic of Poland), A Doctorate Dissertation under the supervision of Prof. Dr. Z. Fedorowicz, Faculty of Finance and Statistics, The Central School of Planning and Statistics (SGPIS), Warsaw, 1972, pp. 2-7.

reforms which have been initiated in the majority of the socialist countries, since 1956 and still under way. These reforms, especially the application of various scopes of decentralization, various scales of using the economic levers and various forms of incentives, resulted in extending the scope of commodity-money relations and strengthened the role and significance of value categories. (1) In this respect, Zienkowski emphasized that:

"The new approach in planning, which is characterized by the tendency to increase considerably the role and scope of decisions by large industrial complexes, means a more importance should be attached to relationships of the financial type in studying the process of reproduction..." (2) inc

In effect, the subject matter of finance, in the socialist economy, has undergone great transformations; in recent years, to be an integrated body of institutional, functional and methodical instruments which can be used as means of the socialist system of economic planning and management.

(1) For detail, refer to:
Ibid., pp. 35-44.

(2) L. Zienkowski, "Present and Future of National Balances", National Accounts and Balances, Central Statistical Office of Poland (Research Centre), Symposium 20th - 23rd. of Feb. 1968, Warsaw, 1969, p.80.

1.2 Purpose and Scope of the Study:

By following this line of thought, the main purpose of this study is to provide a theoretical foundation for the main essence, characteristics, functions, and real scope of the role of finance in a socialist economy. To deal with this purpose, the writer has guided and relied on the Polish practice. The choice of People's Republic of Poland as a case study has been determined:

- * Firstly, for the sake of precision and accuracy, since it is known that the structure and mode of functioning of the financial system differ from one socialist country to another.
- * Secondly, because of the shortage in the Egyptian economic literature for references concerning the theory and practices of socialist financial system, and especially the Polish Practice. This fact has incited the writer to deal with this problem, in order to introduce an attempt which may help, generally speaking, in establishing the real basis for a socialist financial system in Egypt.

2 . Basic Concepts and Definitions:

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Finance may be defined as: the economic category expressing the economic relations which are produced by the processes of creation, accumulation, distribution and utilization of the monetary resources.⁽³⁾

For a proper understanding of the main essence of finance, as defined above, the following points have to be identified:

(I) Finance is a common economic phenomenon, which appears not only in the socialist economy but also in the capitalist one.

(I I) Finance is a form of money, since the specific nature of financial relations is that they are integrally connected with the function of money as a means of circulation and payment. In other words, it seems possible to consider finance as a "partial" money and not a "fully" money. In this connection, Fedorowicz argued that "finance is not an identical concept with the whole monetary phenomenon".⁽⁴⁾

(3) Refer to:

Z. Fedorowicz, "The Role of Finance in Socialist Economic Planning", Problems of Economic Theory and Practice in Poland (Finances and Banking), Edited by Z. Fedorowicz, Polish Scientific Publishers (PWN), Warsaw, 1968, p. 14.

(4) Z. Fedorowicz, Finanse w Gospodarce Socjalistycznej (Finance in the Socialist Economy), Polish Scientific Publishers (PWN, Warsaw, 1966, pp. 11-16.

He continued the argument and maintained that in order to explain the place of the financial phenomenon in the whole monetary system, one has to distinguish between two cases:

- * In the first case, money performs its functions as a measure of value (unit of accounting), and a store of value; and
- * In the second case, money fulfills its function as a means of circulation and medium of exchange.

Regarding the first case, money acts in an "ideal" manner since the expression of the value of commodities in money units is merely "ideal" or "imaginary" act. In this case, one can consider and call the relations produced by these functions of money "monetary relations", such as value relations and price relations.

As far as the second case is concerned, money acts in a "real" or practical manner, and one can consider and call the relations existing "financial relations", i.e., the economic relations resulting from the movement of money among different economic units, such as buying-selling relations, credit relations, tax relations and wage relations.

(III) Finance, accordingly, involves a complex of different economic relations. The varied character of economic phenomena, which is called financial phenomenon, requires a clear-cut division and classification in order to grasp the nature and real dimensions of it. This classification may be performed on the basis of different criteria.⁽⁵⁾ In this respect, one may define two main interrelated kinds of classifications; namely:

- a - The objective classification of finance, which is based on the criterion of combining the movement of monetary objects with that of physical and/or monetary objects. It includes the following constituents:
 - * the monetary revenues and expenditures, which are connected with the purchases and sales of material commodities and services.
 - * the redistributive (transfer) monetary revenues and expenditures.
 - * the accumulated and distributed monetary resources by credit institutions, i.e., lending-borrowing operations.

- b - The subjective classification of finance, which is based on the criterion of connecting the movement of money with the economic activity of the basic classified sectors of

(5) For detail, refer to:
A. El-Sharkawi, op. cit., pp. 126-134

the national economy, e.g., the finance of the state sector, the finance of the household sector and the finance of the private sector ... the finance of industry, the finance of agriculture, the finance of services, and the finance of foreign trade.

Relaying on a certain classification, the systematical presentation of the financial operations of an economy can be performed with the help of some methodical means, such as balances, plans, budgets and tables. This constitutes what the writer calls "the methodological composition of finance". For example, in poland the methodological composition of finance includes the following constituents, classified according to the degree of synthesis, namely:⁽⁶⁾

a - Synthetic methodical means:

- * The financial balance-sheet of the state.
- * The balance of monetary revenues and expenditures of the population.

b - Interlevel methodical means:

- * The state budget.
- * The credit plan.
- * The cash plan.
- * The balance of payments.

(6) For detail, refer to:
Ibid., pp. 150-194.

c - Analytic methodical means:

- * The balances of monetary revenues and expenditures of the state-owned enterprises, which are engaged in the productive sphere of the national economy:
 - Plan of gross profits.
 - Plan of financing stock's increase.
 - Plan of financing investment.
- * The balances of monetary revenues and expenditures of the state-owned enterprises, which are engaged in the non. productive sphere of the national economy.
- * Separate statements of the balance of monetary incomes and expenditures of the population:
 - The balance of monetary revenues and expenditures of private farms.
 - The balance of monetary revenues and expenditures of private sector (outside agriculture).
 - The balance of monetary incomes and expenditures of workers manual and otherwise.

(IV) Finance requires the availability of the following preconditions, in order to manage and control the complex of processes dealing with the mobilization, accumulation, allocation and distribution of the monetary resources; namely:

a - An institutional framework. This represents what the writer calls the "institutional composition of finance". By this, one means the financial institutions, i.e., budgetary, banking and insurance institutions, which manage and control the processes of creating, accumulating, distributing the monetary resources. The institutional composition of finance includes, in Poland, the following: (*)

- The Ministry of Finance.
- The National Bank of Poland (NBP).
- The Agricultural Bank (Bank Rolny).
- The Commercial Bank (Bank Handlowy).
- The General Saving Bank (PKO).
- The Pekao Bank.
- The Saving-and-Loan Cooperatives.
- The State Post Office.
- The Insurance Company.

b - A functional mechanism. This constitutes what the writer terms the "functional composition of finance". By this, one means the tools and instruments which can be used in order to implement, manage and control the processes of mobilizing, accumulating and

(*) For detail, concerning the financial institutions in the Polish economy, their functions and interrelations within the whole system of economic planning and management, refer to:
Ibid., pp. 27-35.

distributing the monetary resources, such as credits, taxes, subsidies and rate of interest. (*)

According to the above conceptual framework, it should be emphasized that:

- These institutional, functional and methodological compositions of finance are closely interrelated and integrated.
- The combination between this set of compositions forms what the writer calls "the financial system".

Needless to say that the financial system, in this sense, is an integral part of the whole economic system.

(*) The place of the tools of the functional composition of finance within the mechanism of the socialist planning system, and the interrelations between the financial and physical instruments can be got in: Ibid., pp. 21-27, and 35-44.

3 . The Characteristics of Finance in a Socialist Economy

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As it has been pointed out, **finance** is a common economic phenomenon which appears in any developed exchange - economy, whether it is a capitalist or a socialist economy. However, the radical differences between the socialist mode of production and capitalist one, regarding the kinds of economic laws and their mode of operation, the nature and functions of the state ...etc, enable one to distinguish between what is termed "socialist finance" and "capitalist finance".

Socialist finance is featured by some characteristics which distinguish it from capitalist finance. Among these characteristics the following, in the writer's opinion, are of a basic importance; namely:

3.1 The Objective Character:

In the socialist economy, finance is an objective category which stems from the persistence of commodity - production and the operation of the law of value in it. The existence of this type of interhuman relations is due to the existence of dual-preference systems in the socialist economy; namely:

- The state preference function, which expresses it self in the national economic plan, i.e., the central plan which defines quantitatively the basic macro - economic proportions, rates and directions, such as the rate of growth of the national income, the rate and components of capital accumulation, and the volume and composition of collective and individual consumption.

- The preference functions of the population, which manifest themselves in purchase and sale on the market, since it is a common knowledge that population in the socialist countries have the freedom of choice and of shaping their consumption pattern, and the private sector still exists in the majority of European Socialist People's Democracies and plays a certain role.⁽⁷⁾

Under these conditions, finance in the socialist economy arises necessarily out of the nature of the reproduction process. As it is known, the reproduction process has two main interrelated sides, namely:

- The physical side, i.e., the processes of production, distribution, exchange, accumulation and consumption of material commodities and services.
- The monetary side, i.e., the processes of creation, accumulation, distribution and utilization of the monetary resources.

Socialist finance deals with the monetary side. In addition, the dynamics and mechanism of socialist finance depend upon the physical side of the reproduction process, in the sense that the formation and allocation of the monetary resources are made-in principle- only for commodity production and commodity circulation. In other words, under socialist conditions the marginal point of the creation and allocation of the monetary resources is determined by the material possibilities, i.e., by the production and distribution

(7) For detail, refer to:
Ibid., pp. 15-16.

of the national income. (*) At the same time, socialist finance influences the physical side of reproduction process by means of the instruments of its functional composition. (8)

3.2 The Comprehensive Character:

By this character, one means that socialist finance deals with the processes of creation, accumulation, distribution and utilization of the available and potential monetary resources of the whole society. It stems from the nature of the socialist mode of production, in which the basic means of production are socially-owned. Under these conditions, the state manages and controls all financial processes of the whole economy. Thus, it is obvious that, socialist finance is not confined to the state budget. Besides, socialist finance comprises the financial operations of the different sectors of the national economy.

While, within the scope of capitalist finance there exists a basic distinction between the so-called "public finance" and "business finance". (***)

(*) This problem will constitute the subject matter of some other further researches, in which the writer will try to investigate how the financial flows are formulated and channeled, and what are the main interrelationships and interdependences between the financial flows and the physical flows. For detail, refer to:

Ibid., pp. 94-148.

(8) For detail, refer to:

A. El-Sharkawi, Some Aspects of Inflation Theory and Inflationary Gap Analysis On the Example of Egypt, A Paper presented as M.S. Thesis under the supervision of Prof. Dr. Fedorowicz, The Faculty of Foreign Trade, The Central School of Planning and Statistics (SGPIS), Warsaw, 1969.

(***) Such distinction does not exist in the socialist economy, due to this important character of socialist finance.

State finance, or the so-called public finance, under the capitalist economic conditions and social relations, cannot cover the financial processes of the whole economy. Hence, it is restricted to the budget of the central government and local authorities. (9)

In this respect, Taylor argued that:

"Public finance is concerned with the operation of the fisc, or public treasury. Hence, to the degree that it is a science, it is the fiscal science, its policies are fiscal policies, its problems are fiscal problems. Public finance is not concerned with the direct regularity function of government over private economy". (10)

3.3 The Uniformity Character:

Socialist finance has a uniformity character since the state, in the socialist economy, operates the whole financial processes of the national economy; namely:

- * The government revenues and expenditures (the state budget).
- * The financial operations of the state-owned enterprises.
- * The activities of the state bank.
- * The credit operations of the other different banks.
- * The financial operations of insurance companies.
- * The monetary incomes and expenditures of the population.
- * The external financial relations.

(9) For detail, refer to:

J. Fredweston, The Scope and Methodology of Finance, Prectice-Hall INC, New Jersey, 1966, pp. 1-21.

(10) P. Taylor, The Economics of Public Finance, The Macmiallen Company, New York, 1955, p.3.

The uniformity character of socialist finance - in this sense - is of a great importance for the uniformity system of economic planning and management in the socialist economy, since it ensures the requirements of the general and specific economic laws of the socialist economy, and also the principle of superiority of centralized planning, guidance and control. This may be justified as follows:

(i) As far as the institutional composition of socialist finance is concerned, it is well known that all financial institutions in the socialist economy are socially owned and under the jurisdiction of the ministry of finance. According to the recent practice of the Polish economy, the following aspects of the institutional structure of the financial system are illustrating its uniformity character; namely:

a - The structural centralized aspect which may be justified by the key position of the Ministry of Finance and the National Bank of Poland in the Polish financial system. The Ministry of Finance is the central organ which responsible for the financial and monetary activities of the national economy as a whole. While the (NBP) is the sole agency for issuing bank-notes and coins, the central institution for credits (long-term and short-term credits), and the central clearing agency for all accounts of the state-owned enterprises and other social institutions. Besides, it is particularly worth-while to mention that:

- * There is no multiplicity of banks which deal with the same kind of activity; and
- * Consequently, there is no competition between banks within the Polish economy, since functions of every bank are determined by law.

b - The high degree of specialization in the credit activities of different banks, which may be observed from the existence of specialized banks in which every one is dealing with the financial activities of a certain sector in the national economy. For example, the National Bank of Poland is specialized - besides its other functions - in granting all kinds of credits to the state-owned enterprises which are engaged outside agriculture. The Agricultural Bank (Bank Rolny) deals with granting credits for production and investment purposes to agricultural and forestry enterprises, farms as well as individual farmers. The Bank Handlowy is dealing with all foreign clearing operations.

(ii) As far as the functional composition of socialist finance is concerned, it is fair to say that there is a possibility of shaping a uniform financial policy in the socialist economy, since the behaviourist pattern of the financial variables - such as credits, taxes and the rate of interest - is controlled by the central determination of their amounts.

- The uniformity character of socialist finance - in the above mentioned meaning - does not necessarily imply a pure - centralized management of the processes of accumulation, distribution and utilization of the monetary resources. In this connection, the writer belongs to the idea that it is rather indicating to the possibility of applying various scopes of decentralization, especially in the field of the financial operations of the state-owned enterprises, without impairing the principle of superiority of centralized planning, guidance and control.

- The uniformity character of socialist finance results from its comprehensive character, and at the same time enhances its planning character, which is dealt with in the following section.

3.4 The Planning Character:

Socialist finance is a planned category. The planning character of socialist finance stems from the general planning character of the socialist economy. At the same time, it constitutes an objective necessity for the system of economic planning and management, in the socialist economy, with its characteristic, institutional and functional aspects. (*)

The planning character of socialist finance is called financial planning. Hence, in order to understand this character, one has to identify the main essence of what is called "financial planning" in a socialist economy. Financial planning, in a socialist economy, may be defined as: a definite

(*) For detail, refer to:
A. El-Sharkawi, op. cit., pp. 21-44.

economic set of the motivated measures which mobilize, allocate and distribute the available and potential monetary resources of the whole economy, in accordance with the planned supply of material commodities and services produced at home or imported from abroad.⁽¹¹⁾

On the basis of this definition, it is though necessary to investigate the following points, so that the essence of this character will be clear enough; namely:

(11) Financial planning, in the socialist economy, consists in the planning of monetary revenues and expenditures of the different economic sectors of the national economy, by means of synthetic statement of accounts. The main essence of this methodological side of financial planning, lies in the fact that, the different methodical means - such as plans, balances, tables, and budgets - are used to translate the financial measures, and their effects, into quantitative estimates of the volume and directions of the financial flows of the national economy.^(*)

(i i) The main purpose of the methodological composition of socialist finance/or say briefly, here, financial plans/ is to ensure that, the flow of financial resources, in the national economy, is in a close

(11) For detail, refer to:

Z. Fedorowicz, Financial Aspects of Perspective Planning, A Paper presented at the Polish.- Egyptian Seminar on Perspective Planning, The Central School of Planning and Statistics (SGPIS), Warsaw, 1970, p. 2-6.

(*) This problem constitutes the subject matter of further studies.

conformity with the flow of material resources in the same economy, as expressed in the physical plans. In this respect, one has to stress the close inter-relationships between the physical planning, i.e., the planning of production, distribution, exchange and consumption of commodities, and the financial planning, i.e., the planning of creation, accumulation, distribution and utilization monetary resources, in the socialist economy. In attempting to determine this important interconnection, one has to emphasize the following:

a - In financial plans, no independent economic targets are established. The scope, contents and objectives of financial plans, in the socialist economy, are derived from the national economic plan, i.e., from the rate of growth of the national income, the volume and structure of material production, its intermediate consumption, the amount and structure of the national income, its division for consumption and investment, the structure of investment, the structure of collective consumption, the level of consumption of different groups of population, the structure of employment, ... etc.

b - Financial plans are not just a monetary translation of the social and economic targets, which are included in the national plan in physical terms, but they can also influence the physical plans. This is due to the fact that, financial instruments are not neutral in relation to production, consumption and investment. Therefore, their effects on the physical plans must be taken into consideration

by changing and adjusting them in accordance to the possibilities and requirements of the financial system.

c - The strategy of financial planning in a socialist economy, is based on the aim of realizing the general economic equilibrium, i.e., the balancing and coordination of material flows and financial flows, by its own instruments and with the help of some methodical means. (*)

3.5 The Planned Dual-Division Character

In the socialist economy, one may divide socialist finance, in a dual-manner, mainly, into the following categories:

- Internal-External Finance,
- Cash - Non Cash Finance,
- Centralized-Decentralized Finance.

These dual-divisions of socialist finance are planned, and based on the administrative rules which are promoting the following modes:

a - The mode of organizing the monetary turnover and settlements of the socialist economy, i.e., how the available monetary resources are utilized by the different economic units of the society, and

(*) This problem will be investigated in other future-studies.

b - The mode of financing capital accumulation of the socialist economy, i.e., how the available and potential financial resources are mobilized, and channelled to finance capital accumulation.

In effect, the writer will try to define the main essence of these dual-divisions of socialist finance on the basis of the preconditions of these two interrelated modes of finance, in the socialist economy, as exemplified with the Polish practice:

(1) Internal-External Finance

It is known that, in the majority of socialist countries - as in Poland, there exists a strict separation and division between the money circulation in the closed economy, using the national currency, and the foreign exchange relations.⁽¹²⁾ To realize harmony between these two separate systems, the state establishes a monopoly of foreign trade and foreign money-exchange. This monopoly gives the state the right to handle any transactions of foreign exchange in a centralized way.^(*)

(12) For detail, refer to:

M. Kucharski, "Money in the Socialist Economy", Problems of Economic Theory and Practice in Poland (Finances and Banking), Edited by Z. Fedorowicz, Polish Scientific Publishers (PWN), Warsaw, 1968, pp. 49-50.

(*) The financial operations with foreign countries are carried on by banks, either in foreign exchange (Dollars, Sterling Pounds, ... etc.), or within the framework of bilateral clearing agreements.

Acting on this principle, it is though possible to classify the socialist finance into the following:

a - Internal (domestic) finance, i.e., the planned processes of creation, accumulation, distribution and utilization of the monetary resources in the closed economy, using the national currency.

b - External (foreign) finance, i.e., the planned processes of accumulation, distribution and utilization of the monetary resources, which are earned from the transactions with the rest of the world.

(ii) Cash-Non Cash Finance

Within the scope of domestic finance of the socialist economy, there exists a planned separation of two areas of internal circulation. (13)

- Cash circulation, which is realized by bank-notes and coins, and
- Non-cash circulation, which is realized through respective entries in bank accounts (transfers of accounts).

Identically, it seems possible to distinguish between:

- a - Cash finance, i.e. finance which is performed by the use of bank-notes and coins, and
- b - Non-cash finance, i.e., finance which is realized by the use of transfer of accounts.

(13) For detail refer to:
Ibid., pp. 50-58.

This planned dual-division of socialist finance is based on the following administrative rules, which are applied in Poland; namely: (14)

a - Obligation for keeping bank accounts for all state-owned enterprises and other institutions, preventing cash operations between these units. In accordance, the execution of cash payments is done by currency withdrawn, especially to a certain purpose, from the cheque account. The cheques have to indicate the purpose for which they are cashed.

b - Every state-owned enterprise is obliged to keep all its monetary means on the account, at only one bank office, and execute all its monetary settlements by the mediation of this bank office. Exceptions from this rule, of concentration of all monetary means at only one bank office, may take place by the agreement of this bank office.

c - The socialist economic units are authorized to keep a cash reserve for emergency payments. The amount of the cash reserve, in most cases, is fixed as 3.000 zlotys (about 100 \$).

d - Proceeds in cash are to be transferred daily, as far as the cash limit set up by the bank is exceeded, with indication of their source.

(14) Refer to:

Z. Fedorowicz, The Organization of Monetary Turnover and Settlement in the Socialist Economy, Memo, 521, Institute of National Planning (INP), Cairo, 1964, pp. 1-4.

e - Every state-owned enterprise has to transfer the profits, taxes and depreciation monthly at least.

On the basis of these rules, it seems possible to state that:

- * the financial operations within the socialized sector (state-owned enterprises and cooperatives) are performed on non-cash base, except wages and salaries,
- * the financial operations within the non-socialized sector (owners of farms, handicrafts, and household) are performed on cash basis.
- * the financial operations between the socialized and non-socialized sectors are performed, in most cases, on cash basis.

(iii) Centralized-Decentralized Finance

In order to define the essence of this planned dual-division of socialist finance, between centralized and decentralized, it seems necessary to identify, first of all, the main preconditions of the mode of financing capital accumulation in the socialist economy, as exemplified with the Polish Practice.⁽¹⁵⁾ In this respect, it is convenient to point out the following:

- 1 - The pattern of financing capital accumulation depends on a number of factors, among which the following two are of an essential importance namely:

(15) Refer to:

S. Przywecki, "Financing of Investment", Problems of Economic Theory and Practice in Poland (Finances and Banking), op. cit., pp. 215-229.

a . The form of ownership of the means of production. Here one may distinguish between:

- investments in the socialized sector, which are carried out by the state-owned enterprises, cooperatives and social institutions, and,
- investments in the non-socialized sector, i.e., the private sector.

b . The level at which the decisions on investments are made. Acting on this element , the following distinctions may be obtained:

- central investment, i.e. the main projects which are of basic importance for the whole economy, outlined by the perspective plan, and approved by the government,
- important rationalization projects, which are suggested within the framework of multi-year plan, and are approved by amalgamations, up to given value limit, and
- rationalization projects, which are approved by enterprises, either as a part of the given value limit of the amalgamations, or as investments in addition to the state investment plan, which do not cause an essential changes in the profile of activity, and the output capacity of the enterprises.

2 - The most important sources of financing capital accumulation, in the socialist economy, are the following:

- the state budget,
- credits (bank and social),
- profits,
- depreciations,
- private funds (savings).

In this connection, one has to stress the following:

- a . In the socialist economy, the value of accumulation, and its share in the national income, is determined by the material possibilities of producing investment goods.^(*) The size and structure of the production of investment goods in the socialist economy, are given as obligatory target. The financing of this target is ensured by the fact that, the state concentrates and distributes profits, taxes, credits..., etc., in a uniformal and planned manner. Moreover, it is observable that savings of population do not play - generally speaking - a decisive role in the mode of financing capital accumulation in the socialist economy.
- b . According to the new financial system, which has been adopted -recently- in Poland, the basic form of financing investment projects is credits repayable by amalgamations out of funds created from depreciation, in addition to a part of profits.⁽¹⁶⁾

(*) It is known that, in the capitalist economy, the value of accumulation is determined by distribution of incomes, and by savings.

(16) Refer to:
J. Trendota, "New Financial System", Polish Economic Survey, op. cit., pp. 13-14.

The net profit^(*), realized by the state-owned enterprises, is divided into:

- a part to be put at the disposal of the enterprise's staff, in the form of material incentives, i.e., workers' fund,
- the remaining part of net profit, after the deduction of interest on fixed capital, is subdivided between the amalgamation and the enterprise, according to the percentage rate fixed by the ministry. The part going to the amalgamation serves, mainly, to cover allowances (subsidies) for deficit enterprises, payments to the state budget, and the amalgamation's reserve and investment funds. While, the part remaining in the enterprise, forms its fund of development, destined to increase the working capital, and to finance small scale investments.

3 - The mode of financing capital accumulation, in the Polish practice, takes its shape in accordance to the above classification of investments and their sources of finance, as follows:

(*) Net profit = Gross profit - turnover tax + Budgetary allowances (if any)
Where: Gross profit = Revenues from sales - Prime cost of product sold.

Refer to:

Z. Fedorowicz, "Financial Planning, vol. 3, Teaching Materials of the Advanced Course of National Economic Planning, The Research Institute on Developing Countries, The Central School of Planning and Statistics (SGPIS), Warsaw, 1970, pp. 12-30.

A - Within the scale of investments in the socialized sector:

a . Central investments are financed from the bank credits, which are paid from budget funds. These credits are repayable out of funds created from profits and depreciation. Only large-scale new investments, in the productive branches, in infrastructure, ... etc., are financed directly from the state budget.⁽¹⁷⁾

b . Projects, which are decided upon by amalgamations, may be financed by profits, depreciation and/or credits.

c . Small-scale investment projects, which are selected by enterprises, could be financed by depreciation and/or credits. Investment, made in addition, may be covered by the so-called development fund.

Thus, from the point of view of financing the investment chapter of the central plan, this contains the following:

Ib : budget-financed investment,

Ic : credit-financed investment,

Io : the enterprise's own resources-financed investment,

It : total investment fund.

$$It = Ib + Ic + Io$$

(17) Refer to:

A. El-Sayed, "Studies in Socialist Planning (Financing Policy in Poland People's Republic, Analitical Study)", Memo. 893, Institute of National Planning (INP), Cairo, 1969, pp. 24-71 (Arabic Edition).

The allocation of investment fund will be controlled by the traditional budgetary methods in the case of (Ib). Allocations of (Ic) will be administered by the state (Central) Bank and other specialized banks. (Io) will be financed from the amortization fund and a part of profits accumulated in the enterprise, as previously explained. This part is regulated by monetary, fiscal and administrative measures, such as taxes, centrally established amortization rates, transfers to the state budget, and to the amalgamations.

B - Within the scale of the non-socialized sector, investments are financed by private funds (savings) and/or credits.

According to the above analysis, it seems to possible, now, to define the last planned dual-division of socialist finance, as follows:

- Centralized finance, i.e., finance which is performed, in a centralized way, by means of the state budget, and credits.
- Decentralized finance, i.e., finance which is realized., in a decentralized way, by means of special funds (out of profit and depreciation) at the disposal of the amalgamations and enterprises, and by private funds (savings).

4 . The Role of Finance in the Socialist Economy:

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In order to determine the real scope of the role of finance in the socialist economy, the argument will start by presenting the following scientific assumption: Within the socialist mode of production, the shape, structure and role of the institutional, functional and methodological compositions of finance, i.e., the financial system, differ from one socialist country to another, and even in the same socialist country from time to time-mainly-in accordance with the following factors:

- i - The character and composition of the ownership's structure of the means of production for the considered socialist country.
- ii - The mode of functioning of the planning system for the considered socialist country.
- iii - The economic level of the considered socialist country.

Regarding the first factor, one may generalize by saying that the role of finance has a wide scope under the conditions of the European People's Democracies. (*) In this respect, the writer belongs to the idea that such situation is due to the nature of the ownership's structure of the means of production, which is prevailing in this group of countries. (18) Under such

(*) The writer has no possibility to outline, here, a comparison between the different socialist countries in this respect. Moreover, he cannot give an answer to the question of, what will be the real scope of the role of finance in the communist mode of production?, out of fear of not being scientific but becoming utopian.

(18) Refer to:
A. El-Sharkawi, op. cit., pp. 13-16.

conditions finance plays an important role, since the state can use it as a tool to:

- Coordinate between the state preference function, which is expressed in the central plan, and the population preference functions, which manifest themselves on the market; and
- Promote the activities of private sector in a direction, which comes in consistency with what is desired by the central plan.

Concerning the second factor, one may find a kind of a functional relationship between the scope of the socialist finance's role within the planning system's mode of functioning, and its degree of centralization. This relationship may be expressed by saying that, the role of socialist finance within the mode of functioning of the planning system has a wider scope if this mode is based on the decentralistic model than if it is based on the centralistic one. In other words, it seems possible to say that, while socialist finance plays an important role in the decentralistic system, it plays rather a passive role in the centralistic one.

As far as the third factor is concerned, the relationship, between the scope of the role of socialist finance and the specific economic level of the considered socialist country, may be expressed by saying that socialist finance plays a more important role in the country which has passed the extensive stage of economic development to the intensive stage of economic development, due to the new needs of this stage in ensuring effectiveness, intensification of production and in making production more effective to meet

the increased needs of the population. (x)

Accordingly, it can be said - using mathematical terms - that the role finance, within the socialist mode of production, is a function in the above-mentioned three variables.

Besides and for the sake of concreteness, the writer will attempt to define the real scope of the role of finance within the system of economic planning and management, as exemplified with the particular case of Poland. (19)

In fact, finance plays an important role in the mode of functioning of the Polish planning system as one of the most significant instrument of realized planned target in physical terms, and the assumptions concerning economic growth in long-term plans. This importance may be justified by the recent economic reforms which have been introduced in the Polish system of economic planning and management, in order to bring it into line with the new needs of development of the productive forces. (20)

Nevertheless, this importance should not be overestimated. In this connection, it seems necessary to emphasize the following points:

(x) The correctness of both of the last two relationships may be justified by the recent economic reforms, which have been initiated in the system of economic planning and management of the majority of socialist countries. Refer to:
Ibid., pp. 35-44.

(19) For detail, refer to:
Ibid., pp. 12-44.

(20) Ibid.

- a - The instruments of the functional composition of socialist finance are used by the central organs of planning to implement the law of planned proportional development of the whole economy. In other words, they are not spontaneous factors, since their behaviourist pattern is determined and controlled by the central organs of planning.
- b - The importance of the role of socialist finance, within the mode of functioning of the system of economic planning and management, as an instrument of realized planned targets in physical terms, appears especially in the market of consumer goods and in the short-run.

As far as the market of consumer goods is concerned, socialist finance plays a very important role as a tool to counter act the lack of equilibrium in this market, i.e., to liquidate the inflationary or deflationary gaps.⁽²¹⁾ While, the role of finance in the market of investment goods is rather a passive one, since the state and its agencies are the main suppliers and

(21) For detail, on the problem of inflation in the socialist economy, and the essence of inflationary gap, refer to:

B. Minc, "On the Symptoms of Inflation in a Socialist Economy", Short Papers on the Theory of Prices and Economic Calculus, Vol.4, Teaching Materials of the Advanced Course in National Economic Planning, The Central School of Planning and Statistics (SGPIS), Warsaw, 1964, pp. 90-95, and

A. El-Sharkawi, Some Aspects of Inflation Theory and Inflationary Gap Analysis, op. cit., pp. 3-34.

purchasers of these goods.⁽²²⁾

As for the short-run, it is known that the functional compositions of socialist finance have, above all, an operative character. Hence, the methodological compositions of socialist finance (i.e., financial plans, balances, budgets, tables) are usually prepared for short time periods (one year, half, ... etc.). In other words, the importance of socialist finance in the short-run stems from the nature of the plans' structure in the socialist economy, i.e., perspective, multi-year and short-term plans. Both the perspective and multi-year plans contain the balance of aims and means of their realization. Whilst they do not contain assumptions concerning the mechanism of realizing the planned targets, i.e. tools of plan fulfillment. This last problem appears, to the full, in short-term plans. Among the tools of plan fulfillment, the financial and monetary ones occupy a central position in short periods of time, because of the limited possibilities of changing the physical tools in it. For example, no important changes in the structure of investment and employment, and consequently in the amount and structure of material production can be achieved in the short-run. In this respect, fedorowicz justifiably stated that:

"In short-term planning, financial plans are not only a test of internal coherence and compatibility of the economic plan, but also an active instrument for establishing equilibrium between demand and supply"⁽²³⁾

(22) For detail, refer to:

Z. Fedorowicz, Finance within the Process of Balanced Growth of the Socialist Economy, Institut International de Finances Publiques, La Hague, 1966, pp. 124-135.

(23) Z. Fedorowicz, Financial Aspects of Perspective Planning, op. cit., pp. 7-8.

c - Socialist finance does not play a basic role within the process of choosing investment projects. In other words, under socialist conditions of production, finance cannot have the function of a primary regulation in the process of choosing investment projects, since it is not necessary to stimulate the disposition of investment by financial means. The very stimulation of disposition results from a set of technological and economical indicators. Hence, it can be said that finance may provide some indicators (such as the index of prime cost and profit, the time of reflux, ... etc.) which may help in taking the decision of choice. But those financial indicators are not the decisive factors in the problem of choice of an investment project, in the socialist economy. It is the real task of socialist finance, in this respect, to find out the most favourable situation for implementing the planned projects.

Here, one may take the example of the role of the rate of interest in this connection. Indeed, the rate of interest is not used in the planned socialist economy so as to regulate the investment process, as in the case of the capitalist economy. (*) It is rather used as a special form of material

(*) In capitalism, the rate of interest is used so as to regulate the equilibrium between supply and demand of money. If there is a high demand for financial resources (credits), the rate of interest will be high too, and vice versa. Proceeding from this fact, and on the basis of the theory of lord Keynes some measures are developed in the capitalist countries, for using the rate of interest so as to regulate economic development. These measures are well known, such as bank-rate policy, open-market policy, and minimum reserve policy. For detail, refer to:

(Cont. on the next page)

incentives for enterprises, so as to increase production, qualitatively and quantitatively, to disclose the available resources, and consequently to make the process of economic growth more quicker. This is due to the fact that the continuity of reproduction process in the socialist economy is ensured by the national economic plan, and not by the spontaneous movements of the rate of interest. In addition, the parametric character of the rate of interest is preserved in the planned socialist economy, since it is determined - as in the case of Poland - by the Council of Ministers. (24)

(Cont. from the previous page)

G. Cassel, "The Nature and Necessity of Interest", Capitalism, Market Socialism and Central Planning (Readings in Comparative Economic Systems), Boston, 1963, pp. 190-196,

A. Hosny, Lectures in Monetary Analysis, Memo. 482, Institute of National Planning, Cairo, 1962 (Arabic Edition).

(24) Refer to:

W. Pruss, "Bank Credit", Problems of Economic Theory and Practice in Poland (Finances and Banking), Edited by Z. Fedorowicz, Polish Scientific Publishers (PWN), Warsaw, 1968, pp. 118-121.

5 . The Functions of Socialist Finance

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The functions of socialist finance mean, generally speaking, the manifestation of its essence, specific characteristics and role in the socialist mode of production. They have their objective basis, and are not merely derived from the economic policy of the socialist state. This proposition stems from the fact that socialist finance, and especially its functional composition, expresses economic laws which are - scientifically interpreted - independent from human consciousness and will.⁽²⁵⁾ Therefore, the real task of the socialist financial system lies in the systematic organization and utilization of its compositions, i.e. institutional, functional and methodological, in such a manner which confirms with the preconditions and requirements of the economic laws of the socialist society.

Socialist finance fulfills, mainly, two basic functions:

- 1 - The distributive function.
- 2 - The control function.

The writer will try, now, to investigate both those two functions respectively:

(25) Refer to:
O. Lange, Political Economy (General Problems), Vol. I, The Polish Scientific Publishers (PWN), Warsaw, 1963, p. 54.

5.1 The Distributive Function:

Finance - as a monetary phenomenon - is used, in any developed exchange-economy, as an economic instrument to distribute the national income. This function was not known until the rise of the capitalist mode of production, in which the production relations pushed the essence of finance to imply the distributive function.⁽²⁶⁾

Socialist finance performs the same function. However, it is thought necessary, in order to understand, properly, the essence of this function, under the conditions of a socialist economy, to deal, first, with the question of; What is meant by social product and national income in a socialist economy?

Indeed, the socialist conception of social product, in a closed economy, is based on the principle that, it is created in the branches which:

- produce it in physical terms, i.e., commodity branches, and
- add a value to the material goods in the former, i.e., productive material services.

(26) Refer to:

Z.Fedorowicz, Ogólne Problemy Funkcjonowania Finansów w Gospodarce Socjalistycznej (General Problems of the Functioning of Finances in Socialist Economy), Polish Scientific Publishers (PWN), Warsaw, 1963, p. 13.

In accordance, social product comprises all commodities and material services, which are produced during a given period of time (usually one year). (27)

Relying on this definition, social product has two closely interrelated sides; namely:

(1) The material side, represented by the production of investment goods and of consumer goods. Here, if one denotes social product by (T), the production of investment goods by (T_1), and the production of consumer goods by (T_2), the following formula results:

$$T = T_1 + T_2 \quad (1)$$

and (2) The money side, represented by the following three components of the value of social product:

- i - the value of absorbed, or consumed, means of production, or what is called, "productive consumption" (C),
- ii - the value of product for workers, engaged in the productive sphere of the national economy, i.e., wages and salaries (V),
- iii - the value of product for society, i.e., the net income of the society (m).

$$T = C + V + m \quad (2)$$

$$\text{and} \quad Y = V + m \quad (3)$$

(27) For detail, refer to:

M. Kalecki, Introduction to the Theory of Growth of Socialist Economy, vol. 29, Teaching Materials of the Advanced Course in National Economic Planning, The Central School of Planning and Statistics (SGPIS), Warsaw, 1907, pp. 5-15, and
O. Lange, Theory of Reproduction and Accumulation, The Polish Scientific Publishers (PWN), Warsaw, 1969, pp. 1-21.

where Y : denotes the national income.

Having in mind this conception of social product and national income, in the socialist economy, the distributive function of socialist finance has two main spheres:

- I - The distribution of the national income between its different uses, in accordance to the plan targets. (*) As it is clear from equation (3), the national income (Y) is divided into two parts: the "necessary" part, which is distributed among workers engaged in the productive sphere of the national economy, for the purposes of direct individual consumption (V), and the "surplus" part, which forms the fund for society, that is used for expending production and non-productive services (m). In this respect, one can distinguish between two interrelated processes:
- a. the accumulation of financial resources, i.e., financial inflows,
 - b. the distribution of financial resources, i.e., financial outflows.

The accumulation of financial resources is performed through the following channels:

- money incomes of the state-owned enterprises, resulting from selling goods and services,

(*) In a socialist economy, the aim is known to be the distribution of the national income according to labour, although there are still some deficiencies in the concrete implementation of this distribution. While, in a capitalist economy, a substantial part of the national income is distributed according to ownership, and not according to labour.

- money incomes of the state farms and cooperatives, resulting from selling agricultural goods,
- money incomes of individuals, such as farmers.

That is what one may call "primary accumulation of the financial resources, or "primary financial inflows". This primary accumulation is followed by the so-called "primary distribution" of the financial resources, or "primary financial outflows", as expressed in Equation (3).

However, the processes of accumulation and distribution of the financial resources do not end in this point. Socialist finance is used to reaccumulate and redistribute a part of the national income. In other words, after the creation, accumulation and distribution of primary incomes, as expressed in Equation (3), a secondary division of incomes, between the population and the state takes place. The main channel of the so-called "secondary accumulation" is the state budget. Redistribution of these reaccumulated resources is understood as "secondary distribution" of a part of already distributed incomes, and results in the formation of "secondary incomes", such as taxes, wages and remuneration of workers of the non-productive sphere of the national economy, rents and pensions.

The redistribution of the national income is necessary in the socialist economy, mainly due to the following factors:

(1) The existence of the non-productive sphere in the national economy. This sphere is necessary for the social and economic development of the society. Thus, since it is known that, the non-productive sphere does not create the national income, in the socialist economy, it must be maintained by the productive sphere of this economy, through the redistribution of the national income.

(2) The circulation of funds in enterprises takes place in such a way that, sometimes, the incomes of these units are not consistent with their expenditures. For example, in one group of economic units, say enterprises, the incomes may be greater than the expenditures, while in other group the expenditures exceed revenues. On this basis, the possibility of lending and borrowing arises, and this is also the case of redistribution.

(3) The social causes of redistribution of the national income, according to which it is necessary that, on one hand, to grant the social incomes to some groups of population, e.g., families with great number of children, students, old people, families with a low income per head, and on the other hand, to take away a part of incomes from other groups of population, e.g., families with a high income per head, profits of the private sector.

According to the above analysis, it seems possible to say that, the outcome of these interconnected processes, which results when socialist finance performs its distributive function, is the formulation of the ultimate magnitudes and structure of the so-called "financial flows", in the socialist economy. (*)

(*) This problem constitute the subject matter of further researches.

II - The second sphere of the distributive function of socialist finance is that, it must ensure the monetary equilibrium. This means, as decided by Prof. Fedorowicz:

"The mutual adjustment of demand determined by part of money incomes earmarked for the purchases of goods and material services, and the supply determined by the value of saleable part of national product".(28)

This implies that, to obtain a full state of monetary equilibrium, in a socialist economy, one must equate the material flows with the financial flows. (*)

5.2 The Control Function

The control function is a part of the very essence of socialist finance, which finds its expression in the socialist state's use of finance as an instrument of controlling the economic activity of the whole economy. In other words, the control by the institutional composition of socialist finance e.g., Ministry of Finance, the banking institutions (especially the National Bank), and Finance Departments of enterprises, constitutes one of

(28) Z. Fedorowicz, "The Distribution of National Income and Money Circulation in a Socialist Economy", Problems of Economic Theory and Practice in Poland: Studies in the Theory of Reproduction and Prices, Polish Scientific Publishers (PWN), Warsaw, 1964, p. 386.

(*) More detailed discussion on this problem may be obtained in the following sources:

Ibid., pp. 385-406,

Z. Fedorowicz, Ogólne Problemy Funkcjonowania Finansów w Gospodarczej Socjalistycznej, op. cit., pp. 76-107, and

M. Kucharski, Bilanse Syntetyczne Gospodarki Narodowej, (Synthetic Balances of the National Economy), Polish Scientific Publishers (PWN), Warsaw, 1967, pp. 138-179.

the most important elements of the whole system of control of the national economic development. Those various agencies of the financial system, in a socialist economy, record economic processes in terms of money, and also control the fulfillment of the national plan through financial and monetary indicies.

In this respect, it seems necessary to emphasize that, the importance of financial control depends upon the power and effectiveness of the financial decisions to influence those processes, by which income and wealth are created and distributed, i.e., material processes. This power, generally speaking, is limited by the scope of administrative and/or physical controls. In this regard, Hodgman distinguished between the degree of control, and the balance between monetary incentives (controls) and the administrative controls.⁽²⁹⁾ By the degree of control, he meant the "intensification" of control over economic variables, by using monetary measures. This degree of control is dependent of the degree of centralization of economic decisions, on the other hand, it depends directly on the level and efficiency of control techniques.^(*)

(29) D. Hodgman, "Soviet Monetary Control through Banking System", Value and Plan (Economic Calculation and Organization in Eastern Europe), Edited by G. Grossman, University of California, Berkely, 1960, p. 106.

(*) Hodgman argued, correctly, that the increased centralization of economic decisions needs not to be accompanied by a similar increase in administrative controls, since the increased centralization could be accomplished by improvements in the techniques of financial control, and, secondly, by the intensification of controls over variables already subject to control. Refer to:
Ibid., p. 107.

The control function of socialist finance could be understood, properly, through the analysis of the following two points:

- 1 - The scale of financial control, and
- 2 - The measures of financial control.

As far as the first point is concerned, i.e., the scale of financial control embraces the whole economic activities and organizations in the socialist economy.⁽³⁰⁾ It means that, the elements of the institutional and functional compositions of socialist finance control the processes of producing and distributing the national income, on the one hand, and they are extended to comprise the whole economic units of the society, on the other hand. Moreover, the methodological composition of socialist finance -as it will be clarified later on- helps in checking and controlling the implementation of the national plan, through the systematic presentation identification of the financial flows and their directions within the national economy.

Regarding the second point, i.e., the measure of financial control, it seems possible to say that the responsibility for financial control, in the socialist economy, is divided - on the macro-economic level - between:

(30) Refer to:
Campbell, "Financial Equilibrium in the Soviet Union", Capitalism, Market Socialism, and Central Planning, op. cit., pp. 273-276.

1. The Ministry of Finance

It is occupying a key position in the Polish financial system, since:

i - It is responsible for the preparation and implementation of the State Budget. By means of it, the Ministry of Finance may fulfill its control function, mainly, through the following measures:

- a. taxation rates, (*)
- b. purchases of goods and services for money,
- c. subsidization either to enterprises or special groups,
- d. surplus policy in the implementation of the budget. (**)

ii - It is authorized to supervise and control the activities of all financial institutions, which are operating in the national economy.

2. The Banking Institutions

Concerning the financial measures of control, which may be undertaken by banks, it is well known that the National (Central) Bank serves as a powerful instrument for centralized control in the socialist economy. This is apparent from a review of the functions of the National Bank of Poland (NBP). (***)

(*) The state budget can absorb the excess money from the economy, through changing this parameter.

(**) By which, the state budget can neutralize the excess money issued by the National (central) Bank.

(***) Refer to:

A. El-Sharkawi, op. cit., pp. 27-35.

On the light of these functions, the National Bank of Poland is carrying out a systematic financial control on the fulfillment of the national plan, mainly, through the following measures:

(i) The quantity of money supply (in cash).

In acting with the quantity of money, the (NBP) - for effective financial control - imposes certain administrative rules, which organize the mode of operation of the monetary settlements and turnover within the national economy, as previously outlined. On the basis of these rules the bank can formulate the cash plan, which regulates the amount of currency in circulation. (*) In this connection, it should be emphasized that:

a. Since transactions, between state owned enterprises and other social organizations, are completed through book entries at the bank's offices, the amount of cash required depends, largely, upon the incomes and expenditures of population.

b. The concentration of all financial assets, and the whole monetary turnover and settlements, of every state-owned enterprise, at only one bank's office on accounts, as previously indicated, creates prerequisites for a current control over the financial economy of those enterprises.

(*) In Poland, as in other socialist countries, the system of the so-called treasury emission of money, i.e., money emission by the State Budget apparatus, is not applied, since the (NBP) is the sole agency of issuing bank-notes and coins. This function of emitting money gives special importance to the banking system.

(i i) The allocation of credits.

The control function exercised by the (NBP) could be performed also through the principles which govern the credit granting. (*) Among those principles, the following are of basic importance; namely: (31)

a. Loans are, exclusively, granted for the purposes of commodity production and commodity circulation.

b. The time of repayment is fixed in conformity with the planned process of the turnover of the enterprise's funds.

c. Loans granted by banks have to be covered by the objects of crediting themselves.

d. Short-term credits are granted for a fixed period (usually one year), and to be used for the prescribed purposes.

(*) Needless to say that, since the (NBP) is specialized in granting all kinds of credits to the state-owned enterprises (outside agriculture), it serves as an important instrument of centralized control of the activities of the socialized sector of the Polish economy.

(31) For detail, refer to:
S. Przywecki, "Financing of Investment", op. cit., pp. 233-237,
Z. Fedorowicz, "Pieniadz w Gospodarce Socjalistycznej", (Money in Socialist Economy), Polish Scientific Publishers (PWN), Warsaw, 1962, pp. 219-237,

" " Credit Planning in the Socialist Economy, Memo 512, Institute of National Planning (INP), Cairo, 1964, pp. 2-4.

6 . List of References:

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