

# THE PROBLEM OF PRICING IN A SOCIALIST ECONOMY

by

*Prof. Dr. Zdzislaw Z. Fedorowicz*

In following considerations we shall understand under the term of a "socialist economy" such a type of social economy, in which all the means of production are in social /i.e. in state or cooperative/ ownership and in which all general economic aims are centrally planned by the government's central planning office. The private ownership of the means of production — if does exist in such a type of economy — does not play any important rôle in the whole national economy and usually is represented by small private farms in agriculture and artisans dealing mainly in the field of services. Thus the private ownership in the socialist economy is limited and has for its subject almost exclusively the means of consumption.

The system of planning in the socialist economy can be organised in different ways; different systems of planning in the socialist economy are often called its "models." It is necessary however to underline, that all possible systems of planning or models of the socialist economy have some common principles. In all effective models of the socialist economy must exist the free choice of a consumer of consumption goods on the market and a free choice of a worker on the market of labour. On the other side in all models of the socialist economy must exist central planning of general lines of the economic development of the country, it means the establishment of the rate of investment, of the structure of investments, of the rate of consumption and of its structure, etc. Hence models of the socialist economy differ among them by ways of making so-called "running decisions": the choice of the volume and structure of production in the framework of existing capacities, the choice of methods of production, of its technology, of raw materials, etc.

In the so-called "centralised" model of the socialist economy these "running decisions" are taken in general by the same cen-

tral planning office, which establishes the general economic plan of the national economy. In this model the enterprises receive from upper organisations detailed plans, which they cannot change and have to implement strictly. In the so-called "decentralised" or "market" model enterprises do not get any directives from the central planning office. They establish their economic plans by themselves, but their decisions are guided by the central planning office through the market mechanism. The preferences of the central economic plan in this system are not expressed by direct orders, but by relations of prices, by taxation, by the differentiated rate of interest on bank credits and so on. Hence in both models finally the aims of the central economic plan are the base for running decisions, but in the centralised model these running decisions are taken by the central planning office and directly transferred to the enterprises, when in the decentralised model these decisions are taken by the enterprises according to the preferences of the central plan expressed indirectly through different instruments of the market mechanism.

In both theoretic models of the socialist economy the prices must be fixed by the central planning office, but their rôle in both cases is different, at least to some extent. The rôle of prices in the socialist economy is very complex one, and therefore the government's price policy is one of the most delicate points of the whole system of the planned economy. In the economic theory as well as in practice the prices must be considered as an instrument of shaping the demand, of shaping the supply, of maintaining the equilibrium on the market, of distributing the national income and finally as an instrument of the economic calculation in the processus of planning.

As in both models of the socialist economy all consumption commodities are divided among consumers with the monetary mechanism on the market — there is no difference in the function of prices as an instrument of regulating the demand in both models. In the limits established by the elasticity of demand on different commodities the relations between prices can be used in order to increase or to diminish the demand and the consumption of different goods according to the social preferences, to the planned structure of the individual consumption.

The differentiation of the relations of prices on different goods leads also to the differentiation of the real income of various social

groups. The structure of the demand depends on the level of the nominal /monetary/ income of an individual, hence the price policy can be used in order to correct the relation of real incomes of various social groups as compared to the relations of their nominal incomes. For example the increase of prices on luxury goods, consumed mainly by the groups of the population disposing of the higher monetary income, can change the relation between real income to the favour of the social groups disposing of lower monetary income, etc. In this sense prices are used — in both models of the socialist economy — as an instrument of the repartition of the national income. This rôle of them is especially important to establish relations of the real income of the rural on one side and the urban population on the other side. The real income of the rural population depends on the relations between the prices on agricultural and industrial goods, and every change in these relations changes at the same time the repartition of the national income among individual farmers on one side and industrial workers and officers on the other side.

The existence of the market of consumption commodities in both models of the socialist economy entails the necessity of using the price policy as an instrument of maintaining the market equilibrium. The retail price of every commodity must be an equilibrium price, it means the price by which the demand on this kind of commodity is equal to its supply. Every deviation of the retail price from this equilibrium level provokes or the increase of unnecessary stocks of goods, or the speculation and the increase of the price to the equilibrium level on the black market. Thus in this area the price policy of the social state is guided by the market rules.

The influence of prices on the supply depends on the model of the socialist economy. In the centralised model the amount and structure of the output are directly established by the central planning office and therefore the system of prices does not play any rôle in shaping the decisions of socialist enterprises. In this model money — inside the socialist sector of the national economy — is considered as a neutral factor, which ought not influence directives given by the central planning office.

In the decentralised model, on the contrary, prices as well as other instruments of the market mechanism, should influence the independent decisions of the enterprises according to the pre-

ferences of the central planning office. Hence in this model money plays an active rôle within the socialist sector and the central planning office must express its preferences as to the amount and structure of production in the relations of prices, in taxation, etc. It demands sometimes the differentiation of the relations of prices for the producers as compared with the relations of prices for the consumers. For example, when the demand on a certain commodity is diminished by increasing its price, at the same time the price for the producer of this commodity should be diminished in order to reduce the supply according to the diminished demand. As the instrument of differentiation of price relations the turnover tax taken at a specific rate on the unit on each commodity can be applied.

The regulation of the production and the supply with the market mechanism is naturally much more difficult than its regimentation with direct orders. On the other hand the decentralised model of the socialist economy is more effective than the centralised one owing to its greater flexibility, to its ability to a direct and quick adaptation of the supply to changing volume and structure of the demand. In practice in all socialist countries adopted systems of the economic administration show the growing tendency to the decentralisation.

The relations between prices for the purposes of regulating the demand and the supply, of maintaining the market equilibrium and redistributing the real incomes among different groups of the population can be found in an empiric way, by observation the reactions of consumers and producers on price changes, by examination the movements of stocks of commodities, by comparing the prices on the unorganised market with these on the organised market /it means in state and cooperative trade/. But there is no empiric way for the establishment of prices for the purposes of the economic calculation, when the costs and the economic results of the allocation of different productive factors in different kinds of the economic activity must be compared in order to find the optimal solution. Current prices, expressing momentary preferences of consumers and momentary possibilities of producers, momentary level of the market equilibrium and other short-run factors of the economic processus cannot be applied for long-term planning. Therefore prices for the economic calculation must be elaborated on theoretical principles. The prices of eco-

economic calculation could also serve as "basic prices," of which necessary deviations could be made in order to establish market prices.

The problem of principles, on which the construction of basic prices should resist, is broadly discussed in the economic literature in socialist countries, and many methods of establishment these prices are proposed. It is generally admitted, that the basic price of every commodity has to comprise its costs of production and a rate of profit, but there is no general agreement on the principles of estimating costs of production or the rate of profit.

For the estimation of costs of production two main methods are proposed: the marginal cost method and the average planned cost method. In the theory, the marginal cost of a commodity is equal to the cost of an additional unit of this commodity, the cost of the increase of its production by one unit, presuming, that such an increase does not demand investments and can be obtained within existing productive capacities. In such conditions marginal cost is equal to the variable cost of an additional unit of the commodity. The prices equal to the marginal costs are considered as most advantageous for the national economy, because they guide the demand towards goods, which supply can be increased at the lowest costs.

The establishment of marginal costs in practice is not so easy as in the theory. In most cases the same commodities are produced by many factories at different costs, resulting from differences between their natural conditions of production, their technical equipment, organisational level etc. Taking into account these differences, the partisans of the marginal method propose to acknowledge as marginal costs the individual costs of the most expensively producing factory. The reason for this proposal is the assumption that the substitution of one unit of a certain commodity by one unit of another commodity means the reduction of the output of the first good and the increase of the output of the second one. Logically, the reduction of the output ought to take place in the factory, producing at the highest individual costs. On the other hand, the increase of the output of the substituable good can be achieved only in factories producing at highest individual costs, because it must be presumed that the idle productive capacities are not maintained in the cheaply producing factories. So finally the result of the substitution ought to be

measured by comparing highest individual costs /treated as marginal ones/ of substituted goods, and therefore the prices influencing the choice made by consumers ought to be based on so defined marginal costs.

This reasoning is criticised by many economists, who point out, that it is suitable only to very special conditions of the calculation of the effectiveness of the substitution of commodities, produced within existing productive capacities, it means in statics. These conditions are not characteristic for the fast developing socialist economy, where in normal conditions all productive capacities are fully engaged in production, and every increase of output requests new investments. And there is no reason for which the costs of production in the newly constructed enterprises ought to be equal to the marginal costs in existing enterprises. So, in a developing economy the economic effectiveness of the substitution of certain commodities ought to be measured rather by comparing their prospective costs in the factories being in construction, but these costs cannot be taken as a basis for "normal prices" because of their uncertainty. It is also underlined, that the basic or normal prices based on marginal costs do not assure the necessary amount of the gross benefit, which has to cover investments and all non-productive expenditures /on the state administration, education, public health, national defence etc./ in the whole national economy. When the prices are fixed at the level of marginal costs, the producers producing at highest individual costs have no benefit at all, and the others obtain differentiated rates of profit, a kind of a rent resulting from differences between their individual costs and marginal costs. In such conditions the global amount of the gross benefit within the whole national economy is not a planned category, adjusted to planned needs of the social and economic development of the country, but an uncertain result of many different factors. In consequence prices based on marginal costs cannot assure the necessary accumulation of monetary funds for financement of the economic and social development and do not assure planned proportions in the economic growth of the country. Therefore most economist in socialist countries pretend, that the normal prices for the economic calculation must be based on average and not on marginal costs of production.

The second proposed method of constructing the normal prices consists on the base of average planned costs of production

of every good /which are known from statistic data/ and on the also planned amount of necessary gross benefit, which has to be earned by the sale of all kinds of goods within the national economy during a certain period of time. This amount of the gross benefit is determined in principle by the amount of expenditures on net investments and on the collective consumption /the state administration, education, public health etc./ But, if even the global planned amount of the necessary gross benefit is determined, there exists still a problem, how to divide this global amount among all productive branches and commodities, or how to determine the individual rate of profit which has to be added to average planned costs of every commodity in order to create its normal price.

The first question arising here is whether the rates of profit for different goods should be established on an equal level for each of them, or on differentiated levels. The reason for arising this question is the practice of so-called "two-level" systems of pricing, adopted in many socialist countries. In this two level systems prices on consumption goods are comparatively high, and prices on production goods comparatively low. In consequence, almost all gross benefit of socialist enterprises is concentrated in industrial branches producing consumption goods, when the branches producing production and investment goods can hardly cover their costs by existing prices.

This "two-level" price system has some advantages. The calculation of prices of production goods /i.e. investment goods, raw materials etc. is by itself extremely simple, because these prices comprise only average costs of manufacturing and a small rate of profit, established as a percentage of costs of production and equal for all products. The calculation of prices on consumption goods in this system is more complicated, their level has to be adjusted to the nominal wages, and their relations have to reflect demand-supply relations on the market. But these factors have to be taken into account by every system of prices, when the current or market prices are to be established. Thus no new problem arises here: in the "two-level" system of pricing the current prices of consumption goods are taken as their normal prices for the purposes of the economic calculation.

Another advantage of the two-level system of prices is the facilitation of the accumulation of budgetary revenues in conse-

quence of the concentration of the gross benefit in only few branches of the industry.

This system has, however, its disadvantages, too. From the theoretical point of view it leads to splitting the monetary system into two parts, in which the monetary unit has a different purchase power, what makes many economic figures and indicators hardly comparable. Especially in economic planning and in the calculation of the economic efficiency of the allocation of productive means in different branches of the national economy, this pricing system provokes great difficulties. This system was compatible with the centralised model of the socialist economy, in which the economic planning was based mainly on material balance-sheets, made in natural units, and in which almost all production goods were directly rationed. But in a decentralised model, where the choice of productive targets, of techniques of production, of raw materials etc. is to be made by independent producers on the basis of calculation, the two-level system of pricing is not admissible. So now in the economic literature in socialist countries is assumed, that only the normal prices, comprising equal rates of profit, are fully comparable and, reflecting the social costs of production /or a value/ of every good, are admissible in economic calculations, aiming to define the economic efficiency of different projects, especially in investments. Of course, current prices established by different conditions of supply and demand on the market, would differ from normal or basic prices and would comprise finally different rates of profit, but these deviations, unavoidable by every system of normal prices, have to be considered only as exceptions from the general tendency to standardise the rates of profit included in prices.

The decision to establish equal rates of profit in normal prices of all commodities does not solve all problems involved here. Equal rates of profit may be established according to different principles. Three main methods are proposed in this domaine :

- 1 — The establishment of the rate of profit proportionally to the cost of wages,
- 2 — The establishment of the rate of profit proportionally to the total costs of production,

- 3 — The establishment of the rate of profit proportionally to the total value of the means of production /to the fixed and floating funds/ engaged in a given branch of industry.

The first of the mentioned methods of establishing the rate of profit is to reflect — how it is pretended by its partisans — the Marxian principle of the creation of the value, according to which the value of every good consists of the value of used means of production /materials, energy, amortisation of the technical equipment/, of the cost of wages and of the surplus-value, created only by the labour force, which is only partially paid by wages. It is presumed, that the ratio of the surplus-value to wages is equal in all material production, so the gross benefit, which is the monetary expression of the surplus-value, should be divided among all branches of the national economy and all products proportionally to wages.

The partisans of the third method /the rate of profit proportional to the value of engaged means of production/ pretend, that the ratio of the surplus value to wages cannot be equal in all branches of the material production, because this ratio depends on the productivity of the labour. If even the higher productivity is better paid, still the volume of the surplus-value produced by the higher productivity is unproportionally greater than that produced by the lower productivity. And the productivity of the labour force depends on its technical equipment. Therefore the rate of profit should be fixed proportionally to the total value of the means of production, engaged in every branch of industry.

The third method should be considered as auxiliary one to the second method — repartition of the gross benefit proportionally to the total costs of production. The rate of profit can be established proportionally to the engaged means for the whole industrial branch or enterprise, but this method is not adaptable for establishment of prices for single commodities, because it is impossible to define the value of productive means engaged in the production of every separate good when the same machines and equipment are used in manufacturing different goods at the same time in the same factory. Thus in such a case the amount of profit, established for the industrial branch according to its capital should be divided among separate goods /and included

into their prices/ proportionally to their total costs of production.

The normal prices, comprising the rate of profit proportional to the engaged capital, would remind by their construction the category of "prices of production" /comprising the average costs of production and the average rate of profit/, characteristic for the free competitive capitalistic system, before its development into monopolistic system. That is why some economists in socialist countries criticise this method as incompatible to the socialist economy, in which neither the competition between different industrial branches exists, nor the allocation of investments is made according to the highest rate of profit. But in prevailing opinion the differentiated level of the "capital exigency" of different industrial branches must be reflected in produced goods, if these prices are to serve as accurate instrument of economic calculation. The real social cost of manufacturing different commodities cannot be measured only by their current costs, but ought to be measured also by investment expenditures per unit.

There are of course also possibilities of combining mentioned methods of the price establishment and of distributing the global gross benefit of the national economy for example in a part proportionally to the engaged capital /as an interest on capital equipment/ and in an other part proportionally to wages. In practice in some socialist countries such combined methods of pricing are already experimented.

The normal or basic prices, serving mainly to purposes of prospective planning, can also serve as departure point for current, market prices, in which should reflect current conditions of supply-demand relations. Though no normal or basic price can change the market equilibrium price, it is very useful to know, how far is the equilibrium level distant from the normal one, and for that purpose the normal prices are indispensable. The differentiation of market prices from normal prices can be obtained with the help of financial instruments, such as the turnover tax, budgetary subsidies etc. The same instruments can be also used in order to obtain differences between the prices for buyers and the prices for suppliers. As it was mentioned, differences of that kind are often necessary in order to fix the market equilibrium at the level defined by social preferences.

The economic theory and practice in the socialist countries is now proceeding in elaboration of more effective methods of economic planning and management ; the problem of pricing, though its complexity, is one of the first to be solved, because its solution is conditioning the progress in other fields.