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EVALUATION OF INFLATIONARY PRESSURES IN THE USSR



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IN THE USSR**

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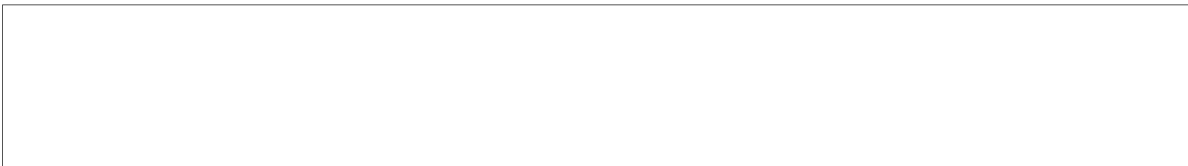
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EVALUATION OF INFLATIONARY PRESSURES IN THE USSR*

Summary and Conclusions

Following 12 years of pronounced success in avoiding major inflationary pressures, the USSR again experienced repressed inflation during 1960-62.** Although the extent of these new pressures is not large compared with the inflationary conditions of earlier periods in Soviet development, there is reason to believe that they are being and must be taken seriously by the present Soviet leadership. The volume of comment in Soviet publications on the problem of purchasing power outstripping consumer output is one indication. Moreover, a survey of civil disturbances in the USSR since Stalin's death shows a growing willingness on the part of the population to strike or riot when real consumer incomes are at stake.

The explanation of the reappearance of inflation can be traced to the decision to give investment and defense needs priority over the consumer in the face of declining rates of growth in industrial production and the stagnation in Soviet agriculture. As the prospects for holding down the rate of increase in household income are dim, the leadership is forced back on either the hope that consumer output can be spurred to the rates of growth prevailing in the early 1950's or the distasteful alternative of squeezing out some of the excess consumer purchasing power. In considering an anti-inflationary program, however, the regime is hedged in to some extent by its widely publicized actions in increasing various forms of transfer payments, abolishing compulsory bond purchases, and promising the progressive elimination of direct taxation.

Having given expansive promises as to consumption levels and still smarting from last summer's experience with civil disturbances, the Soviet leaders can be expected to temporize in curbing excess consumer demand. They may suspect that political controls are not pervasive enough and that the population is not docile enough to permit the sweeping inflation control measures used by Stalin. Instead, the emphasis probably will be on holding down the rate of increase in wages and salaries.

* The estimates and conclusions in this report represent the best judgment of this Office as of 1 April 1963.

** For a discussion of repressed inflation, see III, A, p. 9, below.

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I. Introduction

During the past 4 years, there has been a striking evolution in official Soviet statements concerning the problem of consumer purchasing power outrunning the availability of consumer goods. That the growing emphasis on this question shown in official attitudes reflects a genuine concern can be inferred from a number of Soviet actions taken in 1962 and from a rash of reports of civil disturbances in which consumer protests figured heavily. The mediocre harvests of recent years and the serious failure of the potato crop in 1962 combined with difficulties in production of consumer goods indicate that, on the supply side at least, there is every reason to suspect the existence of inflationary pressures. 1/* The information is less firm on the demand side, but it appears that the upward trend in disposable money income has not abated. Clear evidence of these pressures can be seen in the recent rise in the official index of kolkhoz market prices.

This report discusses the extent of inflationary pressures in the USSR and the problems presented to Soviet policymakers by these pressures. Throughout, the emphasis is on problems caused by the inflation in the Soviet setting to the exclusion of any strains produced by the failure of gains in real consumption levels to match Khrushchev's exuberant promises. The policy alternatives open to the Soviet leadership are then developed together with their implications for various social groups and for economic performance.

II. Recent Evidence of Inflation and Consumer Unrest

A. Official Discussions of Inflation

Perhaps basking in the Soviet success in stamping out the price inflation characteristic of the prewar and immediate postwar years, Khrushchev in 1958 proclaimed:

There cannot be any inflation in our country, for in preparing the budget and product plans we take into account the sums of money to be paid in the form of wages and the necessary quantity of goods to be manufactured in order to maintain the balance between the stock of money and ... manufactured goods. 2/

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More effective controls over wages after 1947 and rapidly increasing production of both food and nonfood goods had allowed reductions in state retail prices for food and nonfood goods of 30 percent and 19 percent, respectively, from 1950 to 1955. Indeed, the enthusiasm for reducing prices during this period at times offset the goals of anti-inflationary policy by creating some excess consumer purchasing power.* The authorities, however, could have eliminated these balances easily by moderating the pace of retail price reduction.

The gradual shift away from the complacency of this period can be seen in subsequent exhortations by Khrushchev. In relating the early success of the Seven Year Plan (1959-65), he noted that public demand for some consumer goods was going unsatisfied and deplored the presence of queues. 3/ In the wake of a series of measures in the realm of personal taxation, pricing of agricultural products, and pensions, which had the effect of pushing up consumer disposable money incomes, he told the January 1961 plenum of the Party Central Committee:

We must do all we can to see to it that our economy constantly satisfies the rapidly growing requirements of the people. Otherwise there may turn out to be a gap between the resources of the purchasers and resources for the satisfaction of their demand. This is fraught with dangerous consequences. 4/

Khrushchev has continued the government's policy in effect since 1948 of holding down increases in average annual money earnings to about 3 percent per year. The success of this policy is largely responsible for the arresting contrast between prewar and postwar inflationary pressures, but it may be provoking worker discontent as well. Somewhat defensively, Khrushchev has told audiences that further increases would have to follow increases in productivity -- "If we raise wages and wage funds are higher than the amount of goods ... you have a lot of money but we won't buy meat and milk in the shops, because production will fall still further behind the population's buying capacity. In such a situation, the speculator is the only one to gain." 5/

* See III, C, 1, p. 18, below.

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The agricultural situation in relation to consumer demand repeatedly claimed Khrushchev's attention. In March 1962 he cited the large increases in the sales of various food products since 1953 and then entered on a curious passage in which he appeared to be second-guessing himself:

But, comrades, why then are we talking about shortcomings, and not only talking but criticising sharply? Because the rise in the output of farm products is lagging behind the rise in people's requirements. It would have been possible to balance supply and demand with the given amount of produce. Had we not been repealing taxes and loans, had we not increased wages as we converted to the seven-hour working day and taken other measures directed toward raising the well-being of the people, we would have reduced the population's demand for food products. ... Given the same situation in a capitalist country, there would seem to be no shortages. The capitalists would raise prices, and tens of millions of people would not be able to buy products under the circumstances. 6/

Given the reference to capitalist price raising, it must have been only after searching consideration of the alternatives that 2 months later the Soviet leadership announced price increases for meat and butter.

B. Price Increases of June 1962 and Subsequent Civil Disturbances

On 1 June 1962 the Soviet government announced that prices paid to collective farms and to households for beef, pork, mutton, and poultry would be increased an average of 35 percent and that procurement prices for butter and cream would be increased by 10 and 5 percent, respectively. The prices paid to state farms for livestock and poultry were set 10 percent below these new procurement prices. At the same time, average retail prices for meat and meat products were raised by 30 percent and butter prices by 25 percent, while prices for sugar and rayon print textiles were reduced by 5 percent and 20 percent, respectively.

The action taken in raising both retail prices and procurement prices was justified primarily on the basis of increasing agricultural incentives. 7/ Procurement prices had been raised before, however,

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without increasing retail prices; so it is reasonably clear that the retail price increases also were designed to bring the quantities of meat and butter demanded into closer alignment with available supplies.* Another reason could have been the desire to reduce excess purchasing power in general, although the aggregate effect must have been relatively meager.** Khrushchev, in discussing the price increases before a Cuban-Soviet youth meeting on 2 June, admitted that as a result of various measures taken in the past to raise incomes the Soviet people had excess purchasing power. 8/

To the same youth meeting, Khrushchev introduced a theme that has gained wide currency in recent months. As if sensing the trouble that lay ahead, he pleaded for an understanding of the necessity for the price increases. The collective farmers, he said, "accepted well" the decision because it increased their incomes, but the urban population, which would purchase meat at higher prices, "is accepting it differently." Then he warned bluntly: "It is necessary to understand and explain this, and to check those who do not understand or want to understand. I repeat, it is necessary to explain and enlighten, and also to check whomever necessary, wherever necessary." 9/

The public reaction to the retail price increases must certainly have been even greater than expected. During June, [redacted] consumer reaction was "irate," that there was "grumbling," and that the price increases were "a definite disappointment for the people." 10/

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[redacted] riots at Novocherkassk, Kemerovo, Aleksandrov, and Groznyy and strikes in other localities. 11/ One of the prominently cited reasons for the disturbances was protest over the price increases.

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* With rising incomes, the demand for these "quality" foods is likely to expand more than the demand for other foods or even for some nonfood consumer goods. Therefore, abstracting from supply shifts, some price adjustments would be necessary even though purchasing power was not in excess over-all.

** Even if the new prices left the real pattern of consumer purchases unaltered, the net increase in annual consumer expenditures would have been only about 1.5 percent of consumer disposable income.

*** Table 1 follows on p. 7. For the methodology, see the first footnote to this table.

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Table 1
Reported Civil Disturbances in the USSR a/*
1953-62

	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>
Total number of disturbances reported	2	1	--	15	6	1	10	7	8	14
Demonstrations and riots	--	--	--	12	2	--	3	--	4	6
Strikes	2	1	--	3	4	1	7	7	4	8
Causes of disturbances <u>b</u> /										
Causes connected with conditions of employment	1	--	--	5	3	1	4	6	1	3
Wages and work norms	--	--	--	3	3	1	3	5	--	2
Other working conditions	1	--	--	2	--	--	1	1	1	1
Causes related to levels of consumption	--	1	--	--	2	--	7	--	8	13
Housing	--	--	--	--	--	--	1	--	--	--
Food shortages	--	--	--	--	--	--	1	--	4	1
Exporting of food	--	--	--	--	--	--	--	--	2	2
State acquisition of privately owned livestock	--	--	--	--	--	--	2	--	--	--
General dissatisfaction with economic conditions	--	1	--	--	2	--	3	--	2	2
Price increases	--	--	--	--	--	--	--	--	--	8

* Footnotes for Table 1 follow on p. 8.

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Table 1
Reported Civil Disturbances in the USSR a/
1953-62
(Continued)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Causes related to political unrest	--	--	--	14	1	--	--	--	--	--
De-Stalinization	--	--	--	5	--	--	--	--	--	--
Intervention in Hungary	--	--	--	5	--	--	--	--	--	--
Suppression of Molotov, Zhukhov, and others	--	--	--	--	1	--	--	--	--	--
Nationalistic demonstrations	--	--	--	4	--	--	--	--	--	--
Other (interference with police action and the like)	--	--	--	--	--	--	1	--	2	1

a. [redacted] Because of the purpose of the survey is the examination of possible changing patterns in civil protest, the tabulation is not limited to the necessarily small number of absolutely verified disturbances. [redacted]

In general, strikes were clearly reported as such while riots and demonstrations more often were reported interchangeably in spite of the fact that the term riot implies disorder to a much greater extent than demonstration. This was especially noticeable in 1962, when all disturbances were reported as demonstrations in spite of reports of soldiers called in, tanks needed to disperse crowds, and martial law resulting in at least one case, at Rostov.

b. In some instances, no specific cause was reported, whereas in others more than one factor was believed to be responsible. Therefore, for any year the number of cited causes may be different from the number of disturbances reported. The tabulation of causes makes no attempt to assess the credibility of the causes [redacted]

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Following an outbreak of disturbances in 1956, the number [redacted] [redacted] dwindled during 1957-58 and then jumped sharply during 1959-62. 50X1
Even more suggestive is the change in the composition of these disturbances over time. After 1956 the number of instances of unrest connected with political protest declined, while the number of disturbances related to economic protest increased significantly. Khrushchev's apparent concern with problems of control takes on more meaning against this background. The disturbances have increased in violence as well.

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[redacted]

If an upswing in consumer discontent is accepted as probable, this still does not show why Soviet policymakers should be worried about inflation itself as opposed to generally low levels of living or the failure of real consumption gains to match the grandiose promises made by the leadership. There are some reasons, however, for believing that the official concern is justified, on both political and economic grounds. These reasons will be developed below.

III. Extent of Inflation

A. Characteristics of Inflation

For the purposes of this report, the inflationary pressures in the USSR are defined to be the excess monetary demand for consumer goods caused by a gap between the amount of money supplied to the economy and the amount actually needed to purchase current levels of output at planned prices. Given the presence of excess demand for goods, "open" inflation results if prices rise in response. If, instead, prices are fixed by decree, "repressed" inflation exists in that consumers are forced to hold cash or savings deposits in excess of the amount desired if more goods and services were available.

In the USSR, almost all nonfood goods and most food goods are sold in state stores at fixed prices. Inasmuch as these prices are changed infrequently, excess monetary demand has resulted typically in repressed inflation. Some of this excess purchasing power then flows into the collective farm or kolkhoz produce markets, where prices rise and fall according to day-to-day changes in supply and demand. These collective farm markets are the only organized free markets in the USSR and therefore represent a barometer of the extent of repressed inflation. The supplies offered on these markets by collective farmers, collective farms, and other cultivators of private plots and owners of livestock have dwindled as a share of the total retail sales of foodstuffs, from somewhat more than 14 percent in 1955 to less than 8 percent in 1961. In both years, however, the collective farm market share of the sales of the perishable foodstuffs sold both in the state retail network and in the collective farm markets was almost double the collective farm

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market share of the total retail sales of all foodstuffs. For particular commodities such as potatoes, the importance of these markets is even greater. In general, their significance is greater in small towns and rayon centers, although some large cities rely on them quite heavily. For example, the share of free market sales in the total sales of foodstuffs in 1956 ranged from 42 percent (Odessa) and 41 percent (Tbilisi) to 31 percent (Tashkent), 10 percent (Sverdlovsk), and 7 percent (Moscow).

Although the prevention of inflation has been "the primary explicit financial objective of the Soviets," 12/ during much of its history the USSR has lived with inflationary pressures that would be unacceptable in a free economy. From 1928 to 1940, prices on consumer goods increased a little more than tenfold, while prices on producer goods and raw materials tripled. Forced-draft industrialization and incentives geared to plan fulfillment, coupled with a relatively free labor market, pushed up wages and consumer income while growth of consumer output lagged. The accumulating excess demand was blown off periodically by raising prices, thereby substituting open inflation for repressed inflation.

After the monetary reform of 1947 the Soviet authorities successfully contained the inflation that had been characteristic of the earlier period. Three factors seem to have been at work. First of all, wage increases were controlled more effectively. From 1930 to 1940, average annual money earnings of workers and employees increased by almost 16 percent per year, and this rate of increase continued in 1946 and 1947. Since 1947, however, the average annual rate of increase has been about 3 percent. 13/ At the same time, the real output of consumer goods and services advanced rapidly, both absolutely and, before 1950, as a share of gross national product (GNP). Finally, a series of relatively high budgetary surpluses greater than the increase in short-term loans made by the State Bank fostered a monetary stringency not present earlier. Underlying the monetary restraint and the increased control over wage increases was an improvement in planning performance compared with the prewar experience. The setting of more realistic plans meant that firms were under less pressure to recruit labor reserves and thereby bid up wages. 14/

Anti-inflationary policy in the USSR must work within the limits established by certain institutional characteristics of the Soviet economy. First of all, the dominance of planning in terms of physical goals means that there is little connection between the demand for consumer goods and services and the supply of these goods and services or the price for productive factors. The inflexibility of supply in the face of shifts in demand removes a restraining influence on inflationary pressures present in the West. Moreover, an effective anti-inflationary program in the USSR must operate on many fronts. It will not be enough

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to attack excess demand in the market for consumer goods by raising taxes on the population when factory managers are assured of a market and may be bidding up wages in an effort to get the labor force necessary to meet and exceed their production quotas. In addition, tax policy is hampered by the traditional reliance on indirect action in the form of turnover taxes on consumer goods. Using this form of taxation to sop up excess consumer cash balances allows full expression to the inflationary pressures already accumulated; by the use of direct taxation, however, a general rise in prices could be avoided.

B. Effects of Inflation on Real Output and Popular Morale

In an economy relying primarily on physical controls, inflation does not have the same impact that it would have in a price-directed economy. In terms of effect on real output, repressed inflation first of all tends to reduce the supply of labor. Marginal workers such as elderly people and working wives tend to withdraw from the labor force when additional income cannot be used to its fullest because of the lack of available goods and services.* Some of the withdrawal may be dictated by time considerations alone -- shortages of consumer goods and extensive queuing increase the expenditure of time and effort required to keep a household supplied. The Soviet currency reform of 1947, which wiped out much of the repressed inflation accumulated from the war and early postwar years, is said to have been followed by an increase in the number of people seeking jobs. 15/ The inflationary process, moreover, is likely to distort the composition of output to some degree. Perhaps the most important consequence of this distortion is the increased incentive that repressed inflation gives to agricultural workers to sell as much as possible at higher collective farm market prices and to shift their efforts to their own "enterprises" -- their private plots and livestock holdings -- at the expense of kolkhoz or state farm work. If consumer goods are not made available, this private output may be withheld even from the collective farm markets and consumed instead by the producers, as was the case during the 1920's.

The accumulation of idle cash balances in the hands of the population encourages speculation and private production -- a favorite target of regime rhetoric. As Khrushchev said, when "wage funds are higher than the amount of goods ... the speculator is the only one to gain. People of my generation remember the period of the civil war, when we were all millionaires of a sort. You paid one million rubles for a box of matches and there was nothing to eat." 16/ For the Soviet authorities, however, the war against speculation has as much ideological content as economic.

* The exception, of course, is the relatively small share of the total consumer expenditures spent for food in the collective farm market.

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If the excess cash balances accumulate in the hands of enterprises rather than consumers, the enterprises are tempted to try to evade controls by hoarding inventories and recruiting additional workers. Insofar as they are successful, real output will be affected and the production mix distorted. The authorities may try to counteract all of this by tightening controls on enterprises, but the application of these controls requires a more expensive bureaucracy. Furthermore, if controls are applied to the distribution of consumer goods through rationing, the costs are even greater.

The influence of inflation on the morale of the population and thus on problems of political control consists mainly in a different set of relations. If inflation is repressed by holding prices at levels that do not clear the markets for consumer goods, the resulting shortages lead to queuing, the use of waiting lists, or other informal methods of distribution. At best, they are irritating to the consumer and perhaps also infuriating when the informal devices show favoritism to particular consumers or groups of consumers. The shortages also present a constant reminder of the failure of levels of living to match Soviet progress in other areas. If, instead, retail prices are raised to clear the market, there may be a shock to consumer morale with the "dangerous consequences" of which Khrushchev warned. The events of the summer of 1962 attest to this. In following a policy of making general periodic retail price reductions before 1956 and selective price reductions since, the Soviet leadership may have conditioned the population to regard any increase in prices as a betrayal.

Even more fundamental than the consequences cited above, however, is the redistribution of income that takes place during inflation. Because of the existence of the collective farm markets, excess consumer demand flows into these markets, raising prices and increasing the incomes of agricultural producers able to supply them. Since 1953 the policy of the leadership has been to increase agricultural incentives by raising procurement prices. Inflation reinforces this redistribution to the disadvantage of the urban worker, who has been the most solid supporter of the Soviet regime. The urban workers, moreover, have continued to forego major wage increases since 1955, while retail prices have leveled off after a period of rapid decline. As a result, their real wages have leveled off or declined since 1955, in sharp contrast to the steady rise in real wages that they enjoyed from 1949 through 1955. Once before, in 1947, the leadership had to resort to a sweeping currency reform in order to squeeze out the cash hoards accumulated in the agricultural sector during the wartime inflation. It would seem that a paramount concern of Khrushchev must be to prevent the urban worker from a further deterioration of his relative position. Observers in the USSR have noted a good deal of disillusionment on the part of these workers and even, incredible as it may seem, nostalgia for the Stalin era. 17/

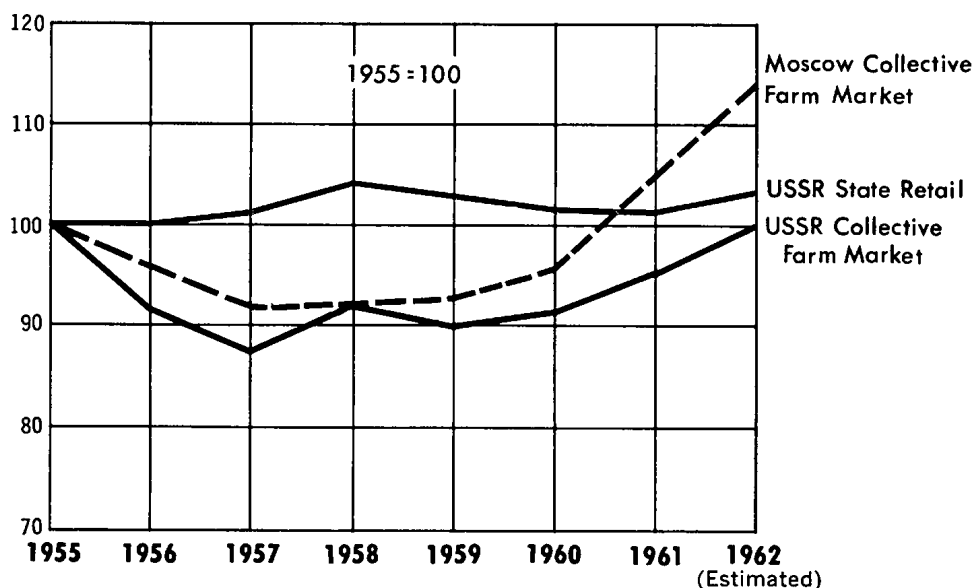
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C. Extent of Present Inflationary Pressures

At best, the measurement of inflationary pressures in the USSR is difficult because of the lack of comprehensive official data on incomes, price levels, real output, and the money supply. No attempt is made in this report to measure an "inflationary gap." Instead, the trends in prices are presented, using the differential between state retail prices and collective farm market prices as the best indicator of inflationary trends over time. Further evidence is provided by comparing estimated time series for disposable money income and real purchases of consumer goods and services. Finally, the scanty evidence as to the behavior of the money supply is introduced.

1. Recent Price Trends

An examination of the retail price series presented in Table 2* shows at once that any inflationary pressures present in the USSR are of relatively recent origin. The trend in prices on nonfood goods in state retail trade was level during 1955-59 and then downward slightly, while the level of state prices on food goods was almost unchanged. For food price trends in the USSR, 1955-62, see the accompanying chart. (The rise in the state retail price index for food**



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* Table 2 follows on p. 14.

** Text continued on p. 16.

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Table 2
Retail Price Indexes in the USSR
Selected Years, 1950-62

	<u>1950</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>
	1955 = 100								
Food price indexes									
State retail	143	100	100	101	104	103	101	101	(103) <u>a</u> /*
Collective farm market									
Total USSR <u>b</u> /	97	100	91	88	92	90	91	95	(99 to 101) <u>c</u> /
In 71 large cities	87	100	89	87	95	91	96	102	N.A.
In Moscow <u>d</u> /	N.A.	100	96	92	92	93	96	N.A.	114
Meat price indexes									
State retail	167	100	115	113	110	110	110	110	N.A.
Collective farm market									
Total USSR <u>b</u> /	84	100	88	89	92	86	93	103	N.A.
In 71 large cities	86	100	89	85	90	87	93	105	N.A.
In Moscow <u>d</u> /	N.A.	100	94	97	90	94	97	N.A.	116
Nonfood state retail price index	123	100	99	99	99	99	97	96	N.A.

* Footnotes for Table 2 follow on p. 15.

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Table 2

Retail Price Indexes in the USSR
Selected Years, 1950-62
(Continued)

	<u>1950</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>
Ratio of collective farm market prices to state retail prices for food	1.14	1.75	1.45	1.34	1.38	1.31	1.35	1.43	1.44 to 1.48

- a. The 1962 index for state retail food prices is based on an estimate of the effect of recent retail price increases.
- b. Excluding sales of producers to other producers in the so-called in-village trade.
- c. The 1962 index for collective farm market prices is based on an estimate of trends in prices in all collective markets and in Moscow collective farm markets.
- d. The Moscow collective farm market price indexes are based on an average of the monthly prices, weighted according to the procedure described in the footnote to Table 3, p. 17, below.

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goods in 1958 was caused solely by a 20-percent increase in liquor prices.) Meanwhile, the collective farm market price index for the country as a whole has been rising since 1957 but by 1961 still had not reached the level of 1955.

The lack of official data on price indexes for 1962 makes it difficult to extend the price indexes in Table 2.* The June price increases in state retail store prices of 30 percent for meat products and 25 percent for butter probably will not push up the state retail price index for food goods by more than 2 percent, because of the low weight of these products in total sales. The increase in collective farm market prices in 1962, however, undoubtedly was substantial. An index of Moscow collective farm market prices based on US Embassy reporting indicates a possible increase of 8 to 14 percent during 1962.

In the Soviet economy the best single measure of the failure of the state to drain off excess purchasing power is the margin between state retail store and collective farm market prices for food. As noted above, the collective farm market sells mostly perishable foods -- meat, vegetables, and dairy products -- and the price levels are determined by supply and demand. Demand in turn depends on consumer disposable income and the prices in state stores and the quantities of goods and services available there. Supplies in the collective farm markets depend on (a) the level of real income of the producers, (b) the relation of prices in the collective farm markets to the prices paid by producers for consumer goods, (c) the total output of the commodities sold in these markets, and (d) the procurement prices and policies of state agricultural procurement organizations. The pronounced fluctuation in prices on these markets is evident in Table 3,** where an index of prices on Moscow collective farm markets is given. This index also offers the best direct evidence available on the increase in inflationary pressures during 1962.

Although during 1959-62 the ratio of the prices in the two markets rose from 1.31 to 1.44 - 1.48 (see Table 2*), the ratio still was far below the ratio of 1.75 in 1955. Furthermore, the ratios prevailing in recent years are still farther below the ratio of about 2.2 prevailing in 1940. Even these ratios overstate the case for the importance of repressed inflation because they do not take account of the diminishing importance of the collective farm markets in the total retail trade. Holzman has suggested the use of a measure of repressed inflation which expresses the ratio of the difference between actual expenditures in collective farm markets and these same expenditures valued at official state retail prices to the sum of state retail sales plus

* P. 14, above.

** Table 3 follows on p. 17.

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Table 3

Index of Moscow Collective Farm Market Prices a/
1953-62

	July 1955 = 100									
Month	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
January	102	112	120	102	98	104	104	109	109	124
February	N.A.	115	114	114	100	107	105	107	103	128
March	101	111	114	116	98	111	106	106	96	117
April	95	108	114	102	99	113	111	101	129	119
May	94	114	122	107	105	100	92	108	119	N.A.
June	93	118	114	103	91	93	100	108	103	133
July	N.A.	119	100	101	97	104	105	118	93	106
August	N.A.	119	112	102	100	98	102	105	N.A.	135
September	N.A.	110	108	113	102	94	104	104	122	139
October	103	114	103	101	114	98	102	106	108	120
November	102	114	104	111	113	99	106	100	N.A.	128
December	110	107	107	101	116	102	104	102	N.A.	118

a. The Moscow collective farm market price index is a weighted, seasonally adjusted index based on prices in collective farm markets. The original compilation (available in this Office) indicates both the number of observations (which vary from one to four) and the price of each commodity. A simple average of prices is used if more than one price has been obtained. The methodology for the construction of the index follows. (1) The index is based on four major groupings (meat, dairy products, fruit, and vegetables) and 18 commodities. (2) The simple average ruble prices of the commodities are converted into index numbers using July 1955 prices = 100. (3) To derive a seasonal adjustment, 12-month moving totals of these index numbers were calculated for 8 years, 1953 - mid-1961. (In a few cases, primarily in 1953, it was necessary to interpolate monthly figures in order to obtain a 12-month total.) Each 12-month total was divided by 12 to yield a seasonal index for the given month. Then a simple average of the monthly seasonal index numbers was taken as the average seasonal index. In some instances where the average seasonally adjusted monthly indexes did not add to 12, a further adjustment was necessary -- that is, multiplication by the appropriate ratios. (4) The price index numbers are then divided by the adjusted average seasonal index numbers to eliminate insofar as possible seasonal bias. (5) Using weights based on the structure of collective farm market sales in 71 large cities in the USSR in 1955, the seasonally adjusted monthly index numbers are aggregated into group price indexes for meat products, dairy products, fruit, and vegetables. In those months where an index number for one or more commodities of a group is missing, as in the case of milk during the summer months, a simple ratio is used to calculate a comparable total for the group. (6) The group price indexes are added to get a monthly collective farm market price index, and these indexes are then recomputed on a July 1955 base.

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collective farm market sales valued at state prices. ^{18/} An index of these adjusted ratios (1955 = 100), represented in the tabulation below, shows sharp declines during 1956-57 and 1959. Only in 1961 does it begin to rise again, and even then it is 12 percent below the level of 1958, 64 percent below the level of 1955, and only about one-sixth of the 1940 index. Perhaps the most surprising aspect of these price level comparisons is the 150-percent increase in the index between 1950 and 1955. By 1959, this rise had been wiped out.

<u>1940</u>	<u>1950</u>	<u>1953</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962*</u>
220	39	87	100	59	40	41	32	30	36	36 to 40

2. Trends in Disposable Money Income and Real Output of Goods and Services

After inspecting the relative trends in disposable money income,** the apprehension over excess consumer purchasing power becomes more understandable. The relevant data in index form are summarized in Table 4.*** From 1950 to 1955, disposable money income increased at an average annual rate of 6.4 percent, with no appreciable difference in the behavior of any of its components.

At the same time, real consumption of goods and services by the population increased by more than enough to allow price stability. The real consumption of food, services, and nonfood goods rose at average annual rates of 10.6, 10.0, and 12.8 percent, respectively. Thus the re-appearance of repressed inflation after 1950 can be traced to the government's policy of reducing state retail prices across the board too rapidly during this period.

From 1955 to 1959, disposable money income began to expand at an accelerated rate of 9.0 percent per year. Although gross incomes of wage and salary workers increased at 6.3 percent per year, or at about the same rate as from 1950 to 1955, the state took other actions that increased consumer disposable incomes. The introduction of higher

* The index for 1962 is based on the assumption that the physical volume of collective farm market sales was the same in 1962 as in 1961.

** This series for disposable income excludes certain urban labor incomes earned in private activity because there is no way to estimate their behavior over time with any confidence.

*** Table 4 follows on p. 19.

Table 4

Indexes of Disposable Money Income and Real Purchases of Goods and Services in the USSR ^{a/}
Selected Years, 1950-61

	1955 = 100							
	<u>1950</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>
Disposable money income	73	100	109	123	134	141	152	165
Of which:								
Gross earnings of workers and employees in state and nonagricultural cooperative sectors	72	100	106	115	122	128	140	155
Collective farm wage payments and house- hold income from sale of farm products	73	100	120	130	147	150	149	147
Earnings in military establishment	102	100	91	86	84	84	83	78
Transfer payments	70	100	116	138	142	156	163	180
Less:								
Direct taxes and bond purchases	78	100	106	89	74	73	73	73
Purchases of food by households in 1958 prices	60	100	107	117	123	131	144	150
Purchases of services by households in 1958 prices	62	100	110	120	132	143	159	179
Purchases of nonfood goods by households in 1958 prices	55	100	110	127	134	145	161	169

a. Income in kind is excluded from these calculations. In 1955, income in kind (mostly foodstuffs) came to about 23 percent of disposable income of households from all sources. Because households over time have been receiving a larger proportion of their disposable income in money, the rise in money income since 1955 has been somewhat greater than the rise in total disposable income.

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procurement prices for agricultural products helped to increase sharply the incomes of collective farmers and household income from the sale of agricultural products. Transfer payments increased at a far greater rate, largely because of the expansion of the pension program. Meanwhile, a 27-percent reduction in direct taxes and bond purchases from 1955 to 1959 caused by reduced income tax rates and the abolition of compulsory bond purchases gave a further impetus to the increase in the disposable money income of consumers.

While disposable money income was increasing at an accelerated rate, the rate of increase in real consumption of goods and services was falling off. Real purchases of food, services, and nonfood goods rose at average annual rates of 7.0, 9.4, and 9.7 percent, respectively. Although the data are not good enough to say that the rise in real purchases lagged significantly behind the growth in consumer purchasing power, a slight inflationary situation probably was developing. The authorities, however, may have more than offset this situation by raising state retail prices on vodka and other liquor in 1958.

It is only during 1960-62 that a solid basis exists for inferring the presence of substantial inflationary pressures. During the 2-year period 1960-61, disposable money income increased by 17 percent, while real purchases of food increased by 14 percent and real purchases of nonfood goods rose by 17 percent. Although the purchases of services increased by 25 percent in constant prices, they are a very small part of the population's purchases. In continuing to reduce state retail prices during 1960-61 while the increase in supplies available to the consumer was lagging behind the growth in disposable income, the regime evidently manufactured a significant amount of repressed inflation.

Preliminary plan fulfillment figures indicate that the gap between the growth in disposable money income and real output of consumer goods and services was not closed in 1962. The total money earnings of workers and employees increased by 7.5 percent while the volume of retail trade in state and cooperative outlets increased by 6 percent in real terms. ^{19/} Sales of food in collective farm markets probably did not increase as much.

Thus, while consumer disposable money income increased at roughly the same pace from 1955 to 1959 and from 1959 to 1962, a slowdown in output of consumer goods provided a basis for a growth in inflationary pressures.

3. Evidence on Behavior of Money Supply

In the USSR the money supply includes the State Bank's currency issue (treasury notes and bank notes), deposit liabilities, and a

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number of less important special liabilities. It also includes coins issued by the Ministry of Finance. The expansion of the money supply during the 1930's contributed heavily to the rapid rate of inflation, although monetary policy in no sense had the independent character that it has in Western countries. If an accurate time series for the Soviet money supply were available, it would be a valuable indicator of inflationary trends. For the postwar years, however, such a series does not exist in the West.

Because of the data limitations, an estimate of the degree of monetary tightness in the USSR can be made only indirectly and with wide margins of error. Raymond P. Powell, in his study of Soviet monetary policy, found that changes in the aggregate supply of money tends to be proportional to changes in the amount of State Bank loans. In turn, the supply of money in the hands of enterprises and the population was inversely related to the size of the state budget surplus. ^{20/} A comparison of the behavior of bank loans and budget surpluses from 1950 to 1961, therefore, should be helpful in analyzing changes in monetary stringency. This comparison is no more than suggestive because there is no way of determining how much of new short-term bank credit is used to increase the money supply or how much of the budgetary surplus involves a reduction of the money supply. ^{21/} In addition, it is probable that some of the state budget revenues during the 1950's included bookkeeping entries that did not reduce cash in circulation.

These caveats should be kept in mind when inspecting the time series for state budget surpluses and changes in State Bank loans presented in Table 5. Nevertheless, the combination of bank loans and

Table 5

State Budget Surpluses and Changes in Short-Term State Bank Loans
 in the USSR ^{a/}
 1951-61

	Billion New Rubles										
	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
(1) Budget surpluses	2.7	3.8	2.5	4.7	2.5	2.2	2.0	3.0	3.6	3.9	1.7
(2) Changes in bank loans	2.1	1.9	0.4	-1.8	0.9	4.4	2.0	5.7	6.3	2.8	4.5
Combined deflationary effect [(1) minus (2)] ^{b/}	0.6	1.8	2.1	6.5	1.5	-2.2	0	-2.7	-2.7	1.1	-2.8

a. Totals have been derived from unrounded data and may not agree with the sums of the rounded components.

b. In line with the accompanying text, the more that budget surpluses exceed the net increase in bank loans, the greater is their combined deflationary effect.

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budgetary policy seems to have been much less deflationary after 1955, largely because of a faster growth in State Bank short-term loans. It is quite possible, then, that a factor given major credit for the success of anti-inflationary controls in the early 1950's, monetary stringency, has lost its influence in recent years.

D. Summary of the Present Situation

The reappearance of repressed inflation in the USSR contrasts markedly with previous inflationary experience in that country in some ways but is similar in one important respect. For 15 years (1947-62) the Soviet authorities were able to hold down the increase in average annual earnings of their labor force far more successfully than in the 1930's. At the same time, high rates of growth in output of consumer goods and services in the early 1950's allowed them to reduce retail prices drastically. The early success of Khrushchev's agricultural policies provided a major bulwark against inflation during these years. After 1955, instead of raising real incomes by general price reductions, the emphasis changed to one of raising incomes selectively through expanding transfer payments, cutting income taxes beginning with the lower income levels, and raising agricultural procurement prices while allowing only a slow growth in money earnings. Between 1955 and 1959, however, the essential prop for carrying out these policies in a noninflationary manner was slipping away. The increases in goods and services available for purchase were barely keeping up with the rise in consumer disposable incomes.

Thus the economy could have absorbed the effects of the accelerated rise in incomes if the rate of growth in output had not begun to fall. This decline in the rate of growth presented the Soviet leaders with difficult choices. Since 1959 they appear to have elected to give investment and military needs priority while consumer-oriented output struggles on as best it can. It is quite likely that the increased stress in policy statements in the past few years on the prevention of inflation stems from a conscious decision of this nature. Once it is accepted that the growth in output of consumer goods and services will not be able to match previous performance, a strict supervision of the growth in consumer incomes is required.

In 1962, some first steps were taken to deal with the emerging inflationary situation. The June state price increases on meat and butter reduced excess consumer purchasing power somewhat, although these increases were accompanied by increases in procurement prices that raised agricultural incomes. This action was followed in September by a suspension of further income tax cuts "temporarily" in the "interests of [the] homeland's security." 22/ The scheduled reduction in the workweek from 41 to 40 hours evidently also has been

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shelved, thus avoiding some of the loss in output that the program for reduction of hours had brought in earlier years, particularly in the consumer goods industries.

IV. Policy Implications

There seems to be a solid basis for believing that the Soviet authorities do face a problem with inflation -- a problem that is unlikely to disappear unless the rate of growth turns upward or they unexpectedly find themselves able to enlarge the share of national product destined for consumption. More than this, there is reason to believe that they cannot follow the old formulas in dealing with inflation. The reasons why this is so are summarized below, and the nature of the alternatives facing the leadership are then considered.

A. Khrushchev's Problem

It has been shown that the inflationary pressures of the past few years do not measure up to those which the USSR has handled before with little difficulty. Stalin allowed wages to run ahead of productivity gains in order to preserve maximum production incentives. When necessary, he raised retail prices or confiscated savings. Fundamental to the success of his policies was an iron control that permitted him to disregard their impact on the real incomes of various sectors of the Soviet population.

What, then, are the reasons for the Soviet leadership's preoccupation with inflation? Is it to be interpreted as an immediate concern or simply a determination to prevent a future deterioration in the situation? There are reasons for believing that Khrushchev may consider inflation a problem now rather than in the future. These reasons rest on the two facts that Khrushchev does not have the same absolute authority which Stalin had and that the Soviet population is not so docile as it was under Stalin.

Certainly Khrushchev's position appears to be weaker. De-Stalinization probably is irreversible in the sense that rigid controls cannot be reimposed without destroying incentives or perhaps endangering Khrushchev's own position. Moreover, it is likely that Khrushchev realizes this. The outbreak of civil disturbances involving economic issues and analogous experiences in the Satellites shows what can occur after a relaxation of police controls and coercion lessens the populace's fear of reprisals against protests of various kinds. It is difficult to visualize Stalin pleading for "understanding" in the manner of Khrushchev's oration of June 1962. Indeed, it is possible that the Soviet leadership's wariness over popular reaction arises from events only partly recorded in the West.

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Since 1953 the Soviet propaganda media have saturated the population with promises of quick progress toward higher levels of consumption, promises that were fulfilled to some extent before 1958. As a result, the Soviet authorities may have provoked their own "revolution of rising expectations." Khrushchev seems to recognize that any action he takes relating to real incomes must be weighed carefully. Yet repressed inflation fosters speculation and private activity that the leadership has opposed ruthlessly in the past and also redistributes income to the disadvantage of industrial workers and the bureaucracy, the classes whose support the government must have.

While making promises as to future consumption levels, the Soviet leadership also has made some commitments that may restrict its freedom of action. The new pension program will become more costly over time, and concrete welfare policies of this sort will be extremely difficult to retract. Equally as important, a reversal of the plans to eliminate income taxation or a reintroduction of compulsory bond purchases could have a serious impact on consumer morale. In many ways, then, although existing inflationary pressures are not so large as those sustained in the past, the regime no longer has a full range of alternatives open to it in dealing with them. In addition, the limited policy choices that might be made embody distasteful economic and political consequences.

B. Immediate Policy Considerations

The extent of the Soviet problem with inflation in the near future will depend on the course of the cold war as well as the rate of economic growth. As far as the available data show, the balance has only in the past 3 years tipped against equilibrium in the markets for consumer goods and services. It is doubtful that the Soviet authorities have given up the hope that economic performance will improve or that they can hold down military spending. If their hopes should materialize, they would have less reason to worry about inflationary pressures; so it seems likely that they will temporize in dealing with inflation. The experience of the past summer was not encouraging as far as any frontal attack on the problem is concerned.

A slowdown in the rate of increase of disposable money income is not likely during 1963-65. To achieve a meaningful slowdown, the regime probably would introduce some scheme of forced savings such as compulsory bond purchases rather than tamper with the schedules of transfer payments -- pensions, sickness benefits, grants, and stipends. Pension payments especially will continue to increase because of the large increments in population of pension age projected over the next 6 years. The pace of annual increases in disposable income may even quicken if a lid cannot be kept on the rate at which wages and salaries go up.

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Since the war the relative success in avoiding inflation can be traced in large part to the firm control exercised over the increases in average annual earnings in state enterprises. Whatever the reasons for this success -- improved supervision by the State Bank, more effective planning, or other factors -- matching the previous record may prove to be the critical area in Soviet stabilization policy. The creeping rate of wage and salary gains in recent years probably has not far outstripped the continuing upgrading of skills in the labor force. As a result, the pressures for wage and salary increases may be building up within the present tight labor market. That this situation prevails is indicated by the increasing number of complaints appearing in the Soviet press concerning enterprises or groups of enterprises exceeding their planned wage expenditures. The frequent references to high rates of labor turnover also may reflect some of the pressures experienced by factory managers in keeping a labor force. Therefore, any Soviet inflation control program probably will feature administrative devices designed to maintain effective supervision over the use of working capital advanced to enterprises through the state budget or through short-term State Bank loans.

For the reasons discussed above, across-the-board price increases do not appear probable during 1963 or during the 2 remaining years (1964-65) of the Seven Year Plan. Even isolated price increases to meet particularly nasty disequilibrium situations in selected markets will not be very appealing when the potential economic gains are weighed against the possible political effects. In any case, if, during the coming year, output does not increase at a higher rate and inflationary pressures continue to increase, the leadership can be expected to take more direct action to reduce consumer purchasing power. Because a one-time raising of prices through higher turnover taxes will not cure a chronic inflationary condition arising from a difference in rates of growth of disposable income and output of consumer goods and services, the action will have to take the form of something like a wage-freeze or a reintroduction of direct taxation on a scale large enough to keep planned levels of consumer output in balance with consumer demand. Some redistribution of income in favor of urban workers could be accomplished in the process by making special levies on income earned in collective farm markets, but such levies would offset to some extent the regime's effort to increase agricultural incentives. Whatever the nature of such a program, the decision to proceed with it will be taken with a good deal of misgiving. Consequently, its introduction is likely to be postponed as long as possible, and some compromises favoring a somewhat larger allocation of GNP to consumption might be reached before its adoption.

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