

RADIO FREE EUROPE *Research*

EAST EUROPE

ECONOMICS/17

18 November 1968

PRE-AUGUST TRENDS IN CZECHOSLOVAK ECONOMIC ORGANIZATION AND POLICY -- III

Since the first two parts of this study were issued,⁺ the events following the Soviet-led invasion on August 21 have brought the post-January developments of the last eight months to a halt and a new phase in Czechoslovak history has begun. Nevertheless, the completion of the study of Czechoslovak developments in economic organization and policy can serve as a benchmark for comparing future policies as they are announced after the invasion by the five Warsaw Pact members. The first part of this study dealt with the unfolding of economic institutional changes. The second part presented the reformulation of economic policy in the field of agriculture and labor. The third part, which is being issued in several sections, will deal with other sectors in which economic policy was being changed. Included are several sections:

- A. Inflationary Trends and Price Policies;
- B. Economic Development and Investment Policies;
- C. Fiscal and Monetary Policies;
- D. Foreign Trade Policies;
- E. Economic Policies Relating to the Non-Industrial, Private and Local Sector;
- F. Functional Representation and the National Front as Alternative Forms of Economic Interest Representation and for Influencing Policies.

⁺) Background Report, Economics/11, Harry Trend, "Current Trends in Czechoslovak Economic Organization and Economic Policy," Radio Free Europe Research, 25 June 1968 (completed 7 June 1968) and Background Report, Economics/12, Harry Trend, "Current Trends in Czechoslovak Economic Organization and Economic Policy -- II," RFER, 16 August 1968 (completed 25 June 1968).

A. Inflationary Trends and Price Policies

Summary: This section traces the issues, problems and contradictions associated with the attempts to modify price policies during the eight months of the Czechoslovak Spring. The Party Action Program of April outlined some of the principles, which were only partially realized in the government economic directive adopted during the first part of August. The complicating inflationary pressures and their sources are reviewed, the discussion surrounding the controversial issue of the market-plan relationships is summarized, and the price problems associated with special economic sectors are indicated briefly.

+ + +

The modifications and direction of change in price policies give an outside observer a sensitive instrument for measuring the extent of economic reform undertaken with any one of the new economic models being implemented in East Europe. Yet, during the transitional period from the old directive system toward goals which become something more than an outline only after a series of trials and errors, a strict application of the price standard may prove to be misleading. Nevertheless, even during this period, the price policy benchmark can serve as a useful reference point, when used with care.

A brief review of the price policies prior to 1967 and the changes instituted during the first year of economic reform in Czechoslovakia will serve as an introduction to the situation on the eve of the end of the Novotny era. This overview also will help to clarify the objectives of the price policies which were being formulated during the eight months of the Dubcek era just prior to the Soviet-led invasion on August 21.

Prior to 1967, factory prices were largely determined administratively, and once set, they were kept rigidly at that level. Some wholesale prices were set in such a way as to assure a very large profit, while still others were deliberately set below production costs. Then the production of the latter commodities required the granting of subsidies from the government in one way or another. In time even the reasons for setting the price for a particular product at a given level was forgotten. Price stability became the dogma, and under this known circumstance, enterprises were prone to report their production costs for a new product at the highest acceptable level. Since no independent basis for determining production costs was available either to the economic ministry in charge of a

particular enterprise or to the State Planning Commission, which was the final storehouse of all such responsibilities, these authorities had little choice but to accept the cost figures supplied to them by the enterprise. The enterprise certainly did not feel averse to playing the game which followed. With wholesale prices rigid and costs padded, the enterprise was frequently able to demonstrate tremendous efficiency improvements and an improving profitability record. Bonuses were granted to those enterprises which learned and played this kind of game with skill. Deception in this productivity game paid off. In other circumstances, such as with the production of raw materials, actual production costs tended to rise due to a policy of favoring workers in these industries with improved wages, as was the case with coal mining, or because costs increased as the richer raw material sources became exhausted and poorer deposits had to be exploited. For many enterprises in this sector, following a policy of maintaining rigid prices meant ever growing subsidies. Knowing that the difference between income and costs would be covered by the state, there was little incentive for a more efficient production and a reduction in the rate of production cost growth. Where substitute raw materials became cheaper, the dogma of rigid prices prevented the adjustment of prices accordingly, which would have favored the less expensive substitute. This certainly was the case in Czechoslovakia where the economy should have started to shift from solid fuels to crude oil and natural gas much earlier but was prevented from doing so because the administratively determined relative prices did not reflect this shift in advantage. Needless to say, this is but one example of prices which were uneconomic. The possibility of subjecting domestic prices to the influence of those determined in world-wide competition was assiduously avoided. The domestic market was insulated against such influences and it was argued that the prevalence of domestic price stability demonstrated the superiority of the planned market over the uncontrolled market system found in much of the capitalist world. In fact, it showed that, if one largely ignored the consequences of irrationally set prices, then it was possible to produce, under a planned economy, any product, however unprofitable. The cost of such choices in terms of potential growths in the standard of living or economic development were significant and largely ignored until the development of cost-consciousness occurred throughout East Europe in the middle 1950s and early 1960s.

In time, the evidence of the ineffectiveness of the administrative price system grew. Uncontrolled increases of unsalable inventories accompanied by growing unsatisfied demand, rising subsidies putting an ever larger strain on the governmental budget, declining quality, increasing difficulty to pay for the growing imports needed to produce for export more and more of the same goods

commanding ever lower prices in world markets, a declining growth rate in production and the standard of living, ever growing investments contributing ever smaller increments to the national income, the more frequent occurrences of various dislocations due to raw material, labor and other barriers, and the increase of plan revisions to such a degree that no one could now claim that there even was a plan, made it clear even to the most ardent defender of the old system that something had to be done. Tinkering with the old system failed to stop the accumulation of evidence pointing to the need for a drastic improvement as soon as possible. Although the need for a new economic model was widely accepted, the struggle over its details and the rate of its introduction became the new center of attention. Compromises, including so-called "dirty" types, became the normal practice in Czechoslovakia.

For 1967 it was agreed to institute a price reform of wholesale prices and some adjustment in retail prices. Even here the infighting was so severe that various short cuts had to be followed if the price and other economic reforms were ever to get off the ground after several postponements.

The new wholesale prices, put into effect on 1 January 1967, were formed on the basis of the old system. The planned costs for 1966 were used as a basis. These costs were adjusted by a series of indices which were to reflect the changes in production costs for particular economic sectors, which would come about as a result of the changes in wholesale prices of raw materials and other resources. Errors in computation, miscalculation about the release of so-called reserves as a result of the introduction of the new system, the lack of clarity of purpose at the center, inadequacy of information about what was actually happening in the economy, the existence of monopolistic tendencies and the signs of the danger of an acceleration of various sources of potential inflationary pressure indicated the possibility of an accentuation of various dislocations. Fears grew and a price freeze was instituted. A large proportion of the so-called free price commodities was reclassified into the two other categories, limit or fixed prices. Higher enterprise taxes and penalties against unwarranted profits were instituted. Price reforms took a giant backward step. By the end of 1967, plans were being made to deal on an individual basis with significant wholesale prices which displayed the greatest deviation from economically acceptable standards. Nevertheless, by this time the economic reformers were more than ever convinced that political reform had to come before a genuine change in the economic system and economic policies could be effected. Following the change in political leadership, economic reform came back with renewed vigor. In connection with economic reform, changes in

price policies became one of the major centers of attention. The threat of inflation, the problem of subsidization and the role of the market provided the three overriding backdrops for the post-January developments in price policies within Czechoslovakia.

Inflationary Pressures.

The government economic directive for 1969, published during the first part of August of this year, recognized the adverse effects of inflationary forces.(1) According to the section on prices:

The course of attaining equilibrium prices is complicated by inflationary pressures that are intensifying in the economy and to which price development must react, at least partially. This creates the tendency of rising prices, the unchecked development of which would multiply the inflationary pressure.

Very early in 1968, fears were expressed that a "mild inflation" would turn into a "disastrous inflation" unless some effective control over the forces giving rise to price increases were counteracted.(2) According to an official estimate made in August, price developments for 1969 pointed to little change. Personal income increase for 1968 was expected to fall within the range of 16,000-17,000 million crowns and in 1969 the income would increase another 19,000-20,000 million crowns.(3) At the same time, it was estimated that, with this income growth, retail turnover should increase by 10 per cent. However, only a growth of 10,000 million crowns in domestic trade could reasonably be expected. This would mean that about one-half of the expected income growth would be uncovered. Other avenues for consumer expenditure, such as would be provided by an increase in the import of consumer goods or greater Czechoslovak travel abroad, had to be developed to fill in this gap.

Not all inflation has been considered to be bad per se. In fact, Sik concluded that some price increase was a necessary and tolerable consequence when seeking a more rational price system. In an interview granted to a Swedish business weekly, Sik showed that he was aware of both the necessity for, and the limits of, price inflation:

We must undertake substantial price changes in order to attain rational pricing. This will probably raise the average price level somewhat.... We shall have to tolerate a small inflation -- but must combat a greater one by all means.(4)

(1) "Directive," Hospodarske Noviny, 9 August 1968, pp. 1, 9-11.

(2) E.g. Rude Pravo of 9 April 1968.

(3) Estimate of Dr. Frantisek Vlasak, Minister of Economic Planning. Rude Pravo, 7 August 1968.

(4) Veckans Affaerer, 25 July 1968.

Minister of Economic Planning Vlasak, however, was more cautious about resorting to retail price changes as a means of reducing imbalances between effective demand and supplies.(5) His position was made clear in an outline of his estimates of the prospects of the Czechoslovak economy up to 1969. After noting that the imbalance amounted to "several billions" [crowns], he added that:

The notion of balancing this disproportion by adjusting retail prices would not be realistic, as the growth of retail prices is limited by the fact that, in relation to wages, it would cause a rise of salaries, the incomes of farmers, pensions, and so forth.

Apparently he feared that a retail price rise would automatically lead to an increase in the demands for various income adjustments to compensate for the price rise and that after these demands for income adjustment were satisfied, the inflation problem would essentially remain unsolved.

A number of causes underlying the incipient inflation have been suggested by various individuals. Growing foreign trade balances, rising investments, accelerated enterprise receipts, expanding inventories, galloping social expenditures and higher wages have all been blamed.(6)

For 1967, the balance of trade surplus reached the sum of 2,400 million crowns c.i.f.(7) Of this amount, 1,000 million came from trade with the socialist countries. If an adjustment factor was applied to convert this surplus into domestic prices, the balance of trade surplus would be much larger. Thus, income was created without making available the corresponding consumer goods for current consumption. It is true that, at some future date, an opposite flow of goods would occur when the debts owed by foreign countries were repaid, but in 1967 no material equivalent was received for this excess of exported commodities. Wages for their production were paid to Czechoslovak workers. In current terms, Czechoslovak was exporting its products throughout the world and "importing inflation."

Control of investment construction in 1967 was effective enough to reduce the total volume below the 1966 level. However, this success proved to be short-lived. The 1968 plan provided for an acceleration in investment construction. Although the level was set at a plane still below the 1966 high level of investments, the

-
- (5) Frantisek Vlasak, "The State Must Have a Hard Economic Policy," Rude Pravo, 21 June 1968, p. 1.
- (6) A more detailed discussion of the various factors can be found in the various special subject sections of this paper.
- (7) A. Balek, "New Economic Management in 1967," Ekonomická Revue, No. 5 May 1968, pp. 216-219.

acceleration over 1967 represents an increase in uncovered income from this source. Equally significant are the developments which are reflected in the construction-completion index. Thus, although the volume of investment construction fell in 1967 as compared with 1966, the volume of unfinished construction was larger than in 1966. Furthermore, the volume of fixed capital placed in operation was below the 1966 level at the very time when the volume of total investments increased by 2.6 per cent. Thus, a larger amount of resources was frozen. The income paid to workers creating this larger amount of resources joined the chase for consumer goods. Ironically, the counter-inflationary effects of the reduction in the domestic sales of machinery due to a moderation in the growth rate of investment construction (1967 machinery and installations were 94.9 per cent of the 1966 total) was frittered away on the foreign markets. What might have turned out to be a buyers' market, with the consequent possibility of shifting to a freer price determination and increased market pressure on the producers, turned out to be a foregone opportunity. The machine producers were able to export their output to "socialist" markets under conditions favorable to them. Thus, the reduction in inflationary pressure from a decline in the domestic machinery purchases was more than compensated by increased foreign sales to Communist countries sold on credit, contributing to the posting of the huge trade balance surplus in 1967.

The miscalculation in the effects of the changes on wholesale prices contributed to the growth of enterprise receipts. Originally, it was estimated that the application of the various price adjustment indices would increase receipts by 19 per cent. Instead, the level of wholesale prices rose by 30 per cent. The significance of the development was singled out on a radio program by a number of professors of the High School of Economics in Prague which included the Rector Vladimir Kodlec, Miroslav Tucek, Kurt Rorsypal, Otakar Mrazek and Ladislav Veltrusky.(8) They noted that, as a result of the growth in enterprise income stemming from the wholesale price rise, inflationary pressure "rose enormously."

When looking for an illustration of the inflationary influence of rising unsold inventories in Czechoslovakia, perhaps the two official figures on this question which are repeated by the Polish publicist on economic affairs Stanislaw Albinowski would serve this purpose with dramatic effect. In the second installment of a series of articles entitled "An Economic Model in the Czechoslovak Socialist Republic -- Throwing the Baby Out with the Bathwater" which appeared in the 2 September issue of Trybuna Ludu, Albinowski noted that, in 1967, out of the 15,000 million crowns growth in national income over 1966, about 11,000 million, or more than two-thirds, went toward adding to the stocks of unsold goods. By the end of the first half of 1968, the accumulated unsold inventories were valued at 200,000 million crowns, a sum equivalent to the entire Czechoslovak national income in 1967! The unsold stocks are also becoming an ever larger proportion of total investments in the country. The amount of unsatisfied income represented by the growing unsold inventories are indeed large.

(8) Radio Prague, 28 March 1968 (1320 hours).

Some have suggested that a rise in wages was also a contributing inflationary factor. Rude Pravo of 9 April tried to explain the causes in terms of a change in the labor relations power balance. The Party newspaper noted that the Czechoslovak trade unions were beginning to take on the function of protecting the workers' material interests and that management had yet to develop sufficient power with which to confront the trade unions. Particularly with a shortage of manpower, which existed in Czechoslovakia, trade unions were bound to obtain the upper hand in wage negotiations. This argument was employed in support of bolstering the enterprise side of the bargaining table by giving them a more independent economic position.

Yet the available evidence does not support the thesis that wage rates rose unduly and thereby contributed to an increase in inflationary pressure. Sik noted that the average wage for the first quarter of 1968 was only 3.6 per cent higher than that of the same period last year.(9) A similar conclusion was expressed by Balek:

Contrary to occasional claims, the increase in wages was not one of the causes of pressure on the market. The principal source of the inflationary trends was the low efficiency of the economy. The 1967 increase in wages was not inflationary in the sense of cost inflation. Wage regulation based on the relationship of the average wages and of the productivity of labor was a stopgap measure.(10)

While the official policy since 1967 has been to abandon the old system of economic management, it seems ironical that it was the continued application of administrative methods of controlling wages which minimized this potential inflationary source. This situation only points to some of the difficulties and contradictions facing the policy makers when they turn to an economic system calling for fewer controls.

Closely associated with the problem of inflation is the economic puzzle of what to do with the prevailing system of subsidies and taxes.

Subsidies and the Turnover Tax

The granting of subsidies and the levying of the turnover tax are common practice throughout East Europe and Czechoslovakia is no exception. Subsidies can be viewed as the negative end of the turnover tax scale, i.e., negative taxation. Viewed in this fashion

(9) Speech by Sik at a general conference of the CS Economic Society on 20 May. Rude Pravo, 22 May 1968, p. 3.

(10) See Footnote 7.

the Czechoslovak turnover tax ranged from a minus 60 per cent up to a plus 1,900 per cent.(11)

State subsidies have been running at around 30,000 million crowns per year.(12) Housing subsidies account for about 6,200 million crowns and another 4,000 million crowns are used for retail price subsidies, of which 2,000 million crowns are for food. Milk subsidies alone account for 1,700 million crowns. Viewed in another way: losses in the case of rent amount to 60 per cent, admission fees 70 per cent, for milk one-third of the price, and in the case of fuels more than one-fourth of the retail price.(13)

The procurement price plus the expenditures for processing and selling exceeded retail prices for the basic foodstuffs, milk and milk products, eggs, poultry and consumer potatoes.(14) The budgetary subsidy for one liter of milk was 0.34 crowns; for one kilogram of fattened poultry, 5.35 crowns; for 10 eggs, 6.80 crowns; and for one metric centner of potatoes, 23 crowns. Thus, the subsidy rate (or negative turnover tax) on poultry is 51 per cent, 25 per cent for consumer potatoes and seven per cent of the retail price for hen eggs.

-
- (11) Editorial comment by "Dalimil" (Pseudonum), "Time Is Winning Over Our Government," Literarni Listy, 30 May 1968, p. 4; in an interview, Vaclav Hula said the tax on tobacco products amounted to 2,800 per cent, Kulturni Noviny, No. 17, 26 April 1968.
- (12) Ceteka, 12 August 1968 report on an explanation of a tax proposal by Deputy Finance Minister Koudelka. Candidate member Josef Hojdar in a speech at the Prague Plenum of the CSCP CC on 3 April 1968; Rude Pravo, 4 April 1968, p. 5, and Premier Cernik in a government statement given at the opening session of the National Assembly on 24 April 1968. Radio Prague Domestic, 24 April 1968 (0910 hours) also cite this figure.
- (13) Interview of Vaclav Hula by Marcel Brozik, "The Bare Truths About the Conditions of Our Economy -- Yes, We Cannot Deny that Prices Are Going Up," Kulturny Noviny, 26 April 1968, pp. 1, 10.
- (14) Vladimir Jenicek, "Procurement Prices and Foodstuff Prices," Socialisticke Zemedelstvi, 12 July 1968, p. 5.

Throughout this discussion of subsidies no allowance is made for various indirect subsidies, which include such items as the granting of preferential treatment which reduce the enterprise contributions to the governmental budget or the association, the lowering of prices on supplies and reducing the interest rate on loans or capital levies.

Not all food items are subsidized. Consumers of some food commodities pay taxes to the government. This is the case for fattened cattle, products made from bread cereals (e.g., flour, bread and pastries), and sugar products (including confections). The turnover tax rate as a percentage of the retail price was 32 per cent for sugar, 18 per cent for cereals and six per cent for milk. The total amount of the turnover tax paid on foodstuffs (average of 20.6 per cent) is approximately 13,000 million crowns, which amount is 93 per cent greater than the state subventions. Thus, on food items alone, the state receives in taxes considerably more than it pays out in subsidies.

The bulk of the governmental receipts from the turnover tax comes from consumer durables. The turnover tax rate on industrial products reaches an average of 29.9 per cent. The individual tax rate on commodities made of flour is as much as 50 per cent.(15) The tax rate on consumer durable goods such as automobiles, television sets and refrigerators fluctuates around the 130 per cent rate.

In reviewing the accumulation of various protective measures which were still in operation, Professor Sik had the following to say to the Czechoslovak Women's Union in June:

Remember, we protect everything. Every state, to a certain degree, carries out a protectionist policy. This means that it protects some of its branches of industry. A new factory which has a bright outlook is protected from competition or similar attacks by a tariff barrier so that it will not be killed by competition from the very beginning. But these are real exceptions in an economy. As a rule, an enterprise must stand up to competition. But, in contrast to this, up to this very day, we have protected all our enterprises, all non-effective enterprises, with the help of a whole system of subventions, subsidies, foreign trade discounts, and price policies. All this helped to make it possible for all to exist.(16)

These various protective measures were applied largely as a result of various political, social and economic pressures. The 30,000 million-odd crowns of direct subsidies have been used in an entirely random fashion and without careful consideration.(17)

(15) Hula interview, op. cit.

(16) Radio Prague Domestic, 5 June 1968 (2020 hours).

(17) "Dalimil," op. cit.

The Czechoslovak government policy as expressed by Premier Cernik was to the effect that both subsidies and the turnover tax had to be reviewed. According to him:

The price of a number of products has become excessive because of the turnover tax, and this slows not only production but also consumption. There is no other way to get rid of these distortions except through a step-by-step increase in the prices of certain products and services, and the decrease of the prices of others. (13)

In this way, Cernik had hoped to avoid adversely affecting the standard of living. Presumably price reductions by adjusting the turnover tax would tend to offset price increases resulting from an abandonment of subsidies. On August 1, the first consumer price adjustments were introduced under the new price policy.

It was hoped that, within the next two years, a considerable reduction in the subsidies would have been made. (19) It was further estimated by Premier Cernik that "the time necessary to eliminate ineffective subsidies will be a maximum of five years." (20) However, Cernik hastened to add that "this does not mean that this concerns all products and all enterprises that today receive subsidies." Nevertheless, a large proportion of the redistribution of income carried out through the use of the differentiated turnover tax and the subsidy system was to be halted. It was also felt to be unfair to penalize effective enterprises through discriminatory taxes and fees in order to benefit the inefficient firms which were receiving various subsidies and financial support, all in the name of maintaining full employment.

In following through with the policy of abandoning certain subsidies the economic policy, leaders recognized that certain difficulties would be encountered. Certainly the fear of the loss of subsidies resulting in the increased possibility of immediate unemployment would serve as a more effective rallying call to the opposition than the diffused benefits of lower prices spread over a large number of unorganized consumers. Human beings as producers have a better fulcrum for applying pressure than they have as buyers of various commodities. Political opponents of the current policy formulators tried to make use of this to their advantage.

Frequently, some other social objective of greater priority prevented a speedier implementation of the new policies on income redistribution through subsidies and the use of the turnover tax. Thus, when the government studied various suggestions made by National Assembly deputies concerning the abandonment of the subsidization of children's clothing and footwear, it was

(13) Statement at opening session of the National Assembly, op. cit.

(19) Cernik at the National Assembly, op. cit. and Oldrich Svestka at the conference of the East Bohemian regional CSCP organization meeting in Hradec Kralove on 21 April 1968, Radio Prague Domestic, 21 April 1968 (1200 hours).

(20) Radio Prague Domestic, 21 June 1968 (1800 hours).

confronted with demands for higher wages which would compensate for the deterioration in the standard of living.(21) The government's response is of interest. According to Radio Prague:

It arrived at the conclusion that, when the subsidies are abolished with respect to these articles, the possibilities for reducing production costs should be studied and that these problems should be solved within the framework of the overall objective of the price and wage policy in 1969-1970.

The government recognized that one of the solutions of these potential adverse effects on the living standard would undermine its wage and price policy, which was already under heavy pressure. It, therefore, decided that one should investigate improvement in production as the best alternative.

Still, in other cases, the government has found itself under external economic pressures which were beyond its control. Export subsidies are a case in point. According to Professor Sik, the "tension in the balance of payments forces us to continue with inefficient production." (22) Thus, the immediate necessity to meet foreign payment obligations substantially reduced the possibilities of launching into a broader program for curtailing subsidies.

Other causes for doubt about a successful and substantial reduction of subsidies were cited during the discussions of the problem. The editorial comment by "Dalimil" on this issue pointed to doubts resulting from the fact that the persons responsible for instituting the protectionism program are still in office, charged with implementing the new policy.

Pointing to Deputy Minister of Finance, Engineer Ler as "one of those who are responsible for these allotments," the writer of the editorial comment in Literarni Listy of 30 May said that his continuance in office is surely paradoxical." "Dalimil's" disappointment went even further and concerned the lack of positive action which would eliminate the accumulated protective measures. He asked:

Has anyone as yet attempted to remove this protective wall of backwardness in our economy, or are there at least concepts in existence which will guarantee that this backwardness will be overcome? Not as far as I know. We do not have to go far for additional examples of this lack of concept.

In spite of these doubts, visible evidence has appeared which supports the view that the new group of political and economic leaders were both sincere about the need to activate prices in the Czechoslovak economy and yet were fully aware of the difficulties which would make the road toward this objective a bumpy one, full of detours.

(21) Radio Prague Domestic, 21 June 1968 (1800 hours).

(22) Speech at the general conference of the Czechoslovak Economic Society on 20 May 1968. Rude Pravo, 22 May 1968, p. 3.

Toward a Policy of Functional Prices

The Party's official views on the reformulation of price policies were first outlined in the Czechoslovak Party Action Program of April 5. This Action Program can serve as a reference point for the discussions preceding and following its adoption. Only a review of the price policy discussion on general aspects and the special price questions can provide an appreciation of the flavor and the wide-ranging character of the issues. The culmination of the views expressed is found to be part of the government's economic directive for 1969, which was adopted almost at the very end of the eight-month-old "Czechoslovak Spring."

The Action Program stressed the importance of the market: "We are placing great hopes in the renewal of the positive functions of the market as a necessary mechanism in the functioning of the socialist economy, and as a check on whether the work in the enterprises has been socially expedient." But the statement was quick to emphasize the difference between a "socialist" and a "capitalist" market. Under the Czechoslovak brand of socialism, "not an arbitrary but a regulated utilization of this market" would be made. The plan and economic policies would be directed toward the "normalization of the market" and against monopoly control of the market by specially favored enterprises. According to the Action Program, one of the policies would gradually eliminate the separation of retail prices from production costs. But in doing this, the retail price level must be controlled so as to assure an annual growth in real wages of "at least 2.5 to three per cent." The standard of living was not to be threatened. According to the Action Program, a major way of controlling the pressures in retail prices would be the introduction of competition by exposing domestic production to the stimulus provided particularly by "mature foreign competition." Protectionism and subsidies were to be removed, while overtime and a "gradual approximation of the prices on the domestic and world markets" would become an "essential" part of the new price policy. This, together with "energetic measures to safeguard domestic stability of currency," would be made possible by producing for the world and domestic markets rather than for inventory, following a "restrictive investment policy" and maintaining an "equilibrium in the balance of payments." In summary:

The Party regards it as a purposeful aim to accelerate the required changes in the current system of price relations and gradually to regulate them through both the pressure of market forces and a purposeful economic state policy, and to establish a proper, rational price system.

The Market and the Plan

Much of the discussions before and after the adoption of the Action Program centered around the question of the role of the market and the market's relationship to the plan. It was readily recognized that it was "impossible to fix 2.5 million prices correctly," and therefore, that the determination of values

would have to be left largely to the market, where "genuine economic prices" would bring about a balance between demand and supply.(23) When asked directly whether supply and demand would regulate the market, as is the case in the capitalist economy, the Ministry of Education answered, "Yes, that will be the case in the consumer goods market." His answer implied that the prices of other types of goods might be determined differently. His position on this question seemed clearer when he discussed the planning of production in the future. Kadlec concluded that the question of preference between consumer and industrial production would be determined by "over-all economic planning." A further probe, however, by the Austrian radio interviewer, elicited from Kadlec a new role for the plan. For the Education Minister, the plan would be "merely an orientation plan, not a compulsory plan." Perhaps the apparent contradiction can be resolved in terms of the determination of the proportions between the two sectors. Once the over-all accumulation rate had been determined, and keeping in mind the future needs of society, the individual consumers would be free to determine the production of specific consumer goods by the act of spending.

Sik had a different approach. He saw the determination of the plan on the basis of consumer choices and not the other way around."(24) Sik concluded that if one begins by assuming proportions assigned beforehand and then, on the basis of this modifies structural changes in the economy, errors would be repeated which once again, would be similar to those made in the past. The market would again reveal these errors in terms of ever-rising unsold inventories of consumer goods. This economic always stressed that one should move from "microstructural changes to macrostructural changes."

All, including Minister of Economic Planning, Dr. Frantisek Vlasak, favored the "liberalization" of prices, which, for the Planning Minister, meant the strengthening of market relations in the Czechoslovak economy.(25) However, in explaining the Czechoslovak position to the Soviets, Premier Cernik provided a different stress when he wrote in Izvestia:(26)

Centralized planning will be improved and built on a scientific basis, and the new system of the management of the national economy will correspond to the new system of state administrative control.

-
- (23) Interview in Vienna of Czechoslovak Education Minister, Vladimir Kadlec by Gerold Christian. Radio Vienna Domestic, 22 May 1968 (1146 hours).
 - (24) Czechoslovak Economic Society Conference of 20 May, op. cit.
 - (25) Frantisek Vlasak, "The State Must Have a Hard Economic Policy," Rude Pravo, 21 June 1968, p. 7.
 - (26) Oldrich Cernik, "Our Road Is the Road to Socialism," Izvestia, 9 May 1968, pp. 4, 5.

Of course, centralized planning which pays heed to consumer choices would be a great improvement over past practice, and it certainly provides a more scientific basis than the application of an across-the-board percentage increase. As was argued in the Action Program for Internal Trade:(27)

A skillful market survey and an analysis of the enterprise's own ventures are essential to the enterprise's trade policy, and also to the macrostructure of the Czechoslovak economy.

However, for reliable surveys to be developed, a number of conditions had to be established. An improved system of statistical information had first to be developed which dealt with such data as personal income, household expenditures, prices and any other information which can be used as the basis for any analytical market study. According to Kobik and his collaborators:

The market for consumer goods can no longer be considered merely as the relationship of purchasing power to total prices, within which the structure of the purchased utility values can be changed arbitrarily.

Not only should enterprises be more informed but so also should the consumer. Thus, Kobik recognized a consumer-protective role for the government. According to him, "it will be necessary to work out the rules of competition, especially with respect to correctly and completely informing the public about products and paid services, their quality and reasonable prices." A "truth in advertising" legislation has a role in a socialist economic system.

A number of other preconditions for the establishment of a "socialist market economy" were also discussed. Thus something had to be done about the inflationary pressures. Minister Vaclav Hula, director of the State Price Office, noted that it would be difficult to free prices as long as inflationary tendencies were "supported" by the administrative status of producers.(28) He viewed the plan and the market as the two essential "feet" on which to base economic policies and observed that, while recognizing this, "we must also respect the fact that we cannot change prices just according to the 'wishes' of the plan or the 'wishes' of a certain system of payment into the state budget." In order to control the inflationary tendencies, a control necessary for the successful operation of a socialist market economy, the "whole economic policy of the country, particularly in financial, credit, wage, and investments policy" must be directed toward this end. Currency reform, one of the alternative economic policies available for an immediate removal of inflationary pressures, was repeatedly declared to be politically unacceptable.(29)

(27) V. Kobik et al, "Action Program for Internal Trade," Noviny Vnitřního Obchodu, Supplement, 26 April 1968.

(28) Ceteka, 4 June 1968.

(29) For example, see Zdenek Vergner, Director of the Research Institute for Economic Planning, "What Is the Actual Situation in the Economy?" Rude Pravo, 28 March 1968.

Producer and market monopolies had to be controlled before the socialist market could be expected to operate effectively. One way would have been to open "the internal market to greater imports of consumer goods." (30) Domestic competition would also have to be enlarged (31) and the relationship between the supplies and distributors had to be changed to give trade a greater opportunity "freely to buy merchandise from suppliers whom they seek out and who are willing to make new products for them." (32) A "buyers' market" had to be developed to replace the prevailing "sellers' market." The Manager of the Bratislava Branch of the Czechoslovak State Bank, Eugen Loeb, summarized the end result of this process:

Together we must see that every crown becomes, so to speak, the vote the consumer casts in choosing his producer and shopkeeper. In this way, you will once again regain the rights of consumers, of which you were robbed by the old system. Then, production will serve consumers and our economy will once again attain its original purpose. (33)

Price Interrelationships

A socialist market economy in which the consumer is sovereign presupposes the establishment of certain relationships between wholesale and retail prices. Although all of the economic models being introduced in East Europe call for an early revision of wholesale prices, most of the corresponding changes needed to reflect the adjustment of wholesale prices are being kept within strict restraints. This problem is left to be solved at some distant future time. Those who favor price reform are fully aware of the need to bring wholesale and retail prices closer in line, but political considerations hinder an early solution. This was equally true in Czechoslovakia. Vlasak, the Minister of Economic Planning, highlighted the difficulty by noting that:

The notion of balancing this disproportion by adjusting retail prices would not be realistic, as the growth of retail prices is limited by the fact that, in relation to wages, it would cause a rise of salaries, incomes of farmers, pensions, and so forth. (34)

Similarly, Premier Cernik saw the important non-economic aspects of the price adjustment process as essentially a question of a conflict of interests:

(30) Vlasak, op. cit.

(31) O. Sik, part two of a television series entitled "On the State of Czechoslovak Industrial and Agricultural Production," Bratislava Domestic TV, 26 June 1968 (1800 hours).

(32) "Action Program for Internal Trade," op. cit.

(33) Bratislava Domestic TV, 21 March 1968 (1837 hours).

(34) Vlasak, op. cit.

The revision of retail trade prices is an important political question. Those who produce the values are producers and consumers at the same time. Interests clash to a certain extent: As a producer, a person is interested in increasing his gross income under our circumstances. But when he walks through the factory gate and enters a retail shop to buy the goods he produces, he is interested in low prices. In other words, the reconciliation of producer and consumer interests is a complex and politically important task.(35)

Nevertheless, all recognize that domestic retail, wholesale and foreign prices somehow must be interlinked. It is the carrying out of this objective that produces new difficulties. In large part, the difficulty comes from the precondition placed on all retail price changes, namely that the standard of living must not suffer. Only a miraculously short-run improvement in labor productivity of unusual magnitude can prevent a retail price adjustment of 10 to 15 years' duration and maybe even a longer period. Sik also found himself facing a dilemma on this question. On the one hand, he recognized that the narrowing of the gap between wholesale and retail prices will take some time and, on the other hand, he also knew that, without the linking of these two levels of prices, Czechoslovakia would be "unable to achieve economic prices," something so necessary to the functioning of a socialist market economy, even a planned one.(36)

Wage-Price Relationship

Before turning to the price questions in particular economic sectors, a short discussion of an interesting wage-price formulation which appeared in a Rude Pravo article on February 4 is of interest. The view presented calls for a reversal of the old price-wage policy. Previously, the planners favored a policy of relative wage stability coupled with retail price reductions resulting in a constantly rising living standard. In the proposed new view, the workers' "money illusion" could be used as a stimulus for greater productivity. The reasoning goes as follows:

Unlike the concept of wage freezing and price cuts, the concept of increasing prices and an even more rapid increase in nominal wages is much more dynamic. The regulation of the standard of living through parallel wage and price increases is psychologically far more effective than the policy of linear price cuts.

A man sees the increase of wages as a recognition and appreciation of his work and his personal merits, while price cuts are looked upon rather as a gift of the government to anonymous people.(37)

(35) Hungarian State Radio and TV Networks' interviews of Premier Oldrich Cernik. MTI Domestic Service in Hungarian, 20 April 1968.

(36) Ota Sik: "Wages - Prices - Democracy," Prace, 31 May 1968.

(37) As reported by Ceteka, 4 February 1968.

With wages generally rising more rapidly than prices, the goal of an ever-rising standard of living could be maintained and the difficult problem of interlinking wholesale and retail prices brought closer to a solution. In addition, more room for maneuver would be provided for the important policy favoring greater wage differentiation.

Price Policies in Specific Economic Sectors

Until now this paper has dealt largely with general questions pertaining to price policies. For illustrative purposes, a number of problems pertaining to the price policies of specific economic sectors have been selected to indicate the wide spectrum of the complexities the policy makers faced when they decided to overhaul the price system. The particulars discussed are not intended to provide a comprehensive cross section but rather to give only an indication of some of the problems involved. The specific economic sectors include: retail trade, agriculture, communications and transportation, fuel and power, and foreign trade.

Retail Trade Prices

The question of the proper relationship between retail, wholesale and foreign trade prices has already been discussed as a general issue and this question need not be reopened.

Very early, it was decided not to increase rents or basic food prices before 1970 at the earliest. The maintenance of the standard of living was a political decision taken by the Central Committee Plenum in December, 1967, and subsequent policy expressions on this question repeated a continued respect for this basic point of price policy.(38) This did not preclude any changes in retail prices. Following another basic provision of price policy, the need to establish a proper wholesale-retail price relationship, the government introduced a number of retail price changes, effective June 1. To make this price maneuver more palatable, price decreases were announced at the same time as price increases were made public.(39) Thus, plain materials were more expensive and printed materials made cheaper. Men's hat prices went up, but women's hats, berets and caps were made cheaper. Utility glassware, television sets and certain sports goods had higher price tags, while the prices of the type "381" electric refrigerators with a 40-liter capacity and of certain types of soap were reduced. The increases were justified on the basis of covering rising production costs and the price reductions reflected an attempt to help clear inventories of products with inadequate

(38) Miloslav Kohoutek, Deputy Chairman of the State Planning Commission at a meeting of the National Assembly Health Committee held on 22 March. Ceteka, 22 March 1968.

(39) Radio Prague Domestic, 30 May 1968 (1200 hours).

demand. Assuming sales at 1967 levels, the overall price changes would mean a net increase of consumer expenditures of about 10 million crowns. The government continued to observe that the price policy of maintaining stable rents and basic food prices was being sustained.

Several months later, the trade unions were criticized for not participating more extensively in the price discussions and policy determination. The secretary of the Czechoslovak trade union council, Kymlik, made the following observation at a trade union council meeting held on August 19:

The increase in prices came, then a governmental directive for the economic development in the next year, and where were the trade unions? They were simply not present at most of the talks, and that must not happen again.(40)

In conjunction with the resolution adopted by the Economic Council on May 2 recommending to the government the introduction of a five-day work week effective 29 September 1968, the Economic Council directed that price differentials be considered for goods and services sold on Saturday and Sunday.(41) The additional receipts were to be used to pay premium wage rates to the sales personnel working on weekends.

Four other questions dealing with retail prices deserve attention: the trade markup, the role of the turnover tax, the role of the Ministry of Domestic Trade, and consumer goods supply. These are discussed in the "Action Program on Internal Trade."(42)

Those interested in revising retail price procedures in Czechoslovakia have asked for the institution of an "economic markup." According to them, an economic markup "should help to distinguish good and bad enterprises, and to differentiate their position on the market according with the fulfillment of their basic mission." The current average retail markup in Czechoslovakia of 10.7 per cent is considered to be inadequate when compared to the practice in Western Europe of approximately 28 to 30 per cent (In West Germany and Belgium in 1960). The recommendation was made to favor greater independence of the enterprises in forming prices and trade markups. Accordingly, the current practice of establishing fixed percentual markups would be replaced by a practice which would allow the "free formation of the trade discount markup", in accordance with the results of the supplier-customer negotiations, the production conditions, the nature of the merchandise sold, and the market situation."

(40) Radio Prague Domestic, 19 August 1968 (1900 hours).

(41) Ceteka, 2 May 1968.

(42) V. Kobik et al, op. cit.

As a prerequisite for restoring the market's function, a reform of the turnover tax system is considered to be necessary. The "unwarranted differentiation of the turnover tax would be replaced by a uniform tax rate" thereby eliminating the equalizing role of the turnover tax.

According to the recommendations of the Domestic Trade Action Program, the Ministry of Domestic Trade should determine the fixed and limited retail prices and any changes, all within the limits set by the government. But the ultimate goal, as expressed by the drafters of the program, indicated that:

We must consider that, eventually, prices will be primarily the result of direct negotiations between trade and production enterprises.... To ensure the effective influence of foreign prices, it has been proposed to reclassify imported consumer goods basically into the category of free prices.

Simultaneously, a role for central agencies was also envisaged:

It will also be necessary to introduce effective central price control to prevent the free movement of prices from unfavorably affecting the population's living standard. The central agencies must plan the price level for sufficiently large groups of products, and must set the development of prices with a tolerance such that individual prices may react fairly to the market. Only the prices of the specific standards of certain basic needs may be set centrally. But, at the same time, it is necessary to work out the basic conditions for the market and the movement of prices.... The central agencies however, should control the development of prices indirectly, for example, by manipulating with the state reserves on the market, through import policy, with credit operations, state loans, and eventually, even with subsidies to reduce prices.

To counteract the inflationary pressure, production of consumer goods would be expanded, even if this required a redistribution of resources and capacities and with significant increases of consumer goods imports. The former program can only absorb a part of the inflationary pressure, because production also creates additional income. The level of taxes and the proportion of the additional tax receipts used to retire money from circulation will determine the degree of the counterinflationary effect. The latter program will be limited by the level of accumulated favorable payment balances and available foreign credits. The largest part of the balances has been earned in East Europe and the developing countries. Sik and others suggested that part of the hard currency loans be used to import much-wanted consumer goods from the capitalist, economically developed countries. It was hoped that a wider selection of desirable consumer goods would stimulate greater labor productivity at home.

Agricultural Prices

Recent price changes affecting agriculture have left this sector in a worse position, according to Vladimir Janicek, a Candidate of Science.(43) As a result of the 1967 price changes, the overall price increase in agricultural prices reached an index of 139, procurement price increases posted an index of 121 and the wholesale building industry price index was approximately 140. The ratio between prices received and prices paid by agriculture deteriorated, favoring industry and the building trade.

Equipment prices were considered to be too high for the quality offered by the agricultural machinery industry of Czechoslovakia.(44) Inventories of unsold agricultural machinery grew during 1967 and 1968. As to quality, the State Testing Station for Agricultural and Forestry Machinery at Repy considered that 50 per cent of the machines have demonstrated an unsatisfactory level of performance and quality. Even those most recently placed into production suffered in comparison with those available in the West. Part of the difficulty is the long delay between the period when a piece of equipment is developed and finally produced and the lack of a program of continuous product development. Thus, when first introduced, the harvesting threshers produced by Czechoslovakia were rated at the top of the world level for this type of machinery. Now, in comparison to the Volvo 1000 and John Deere 750 combines, the Czechoslovak substitute is considered to be obsolete and shows grain losses during operation which are 100 per cent higher. Rather than buy the expensive and obsolete machinery, agricultural enterprises have preferred to repair their old machines.

Farm wages have also increased, making for higher costs. By the end of 1967, state farm wages increased to 137.3 per cent of the 1960 level, and for the collective farm to 161.6 per cent. In absolute terms, the state farm wage reached 1,473 crowns and for the collective farmer 1,181 crowns, both still some 10 to 20 per cent below the industrial and non-agricultural wage level.

At first, a comparison with other countries may indicate that the Czechoslovak farm has a very favorable prices-paid -- prices-bought ratio. Thus, according to Vladimir Janicek, the Czechoslovak farmer pays for his equipment in natural products about 37.4 per cent less than the West German farmer, and about 47.4 per cent less than farmers in France. Even in per area yields, the figure comes to about 5.4 per cent less than for the West German farmer and 45.9 per cent less than in France.

(43) Socialisticke Zemedelstvi No.22, 31 May 1968, p. 5.

(44) Oldrich Dolezal, "Saturation of Agriculture with Mechanized Equipment," Socialisticke Zemedelstvi, 12 July 1968, pp. 3, 5.

More refined measurements give an entirely different picture. The crop production area necessary to acquire internal investment sources to buy a given unit of agricultural equipment, such as a tractor, is 59 per cent smaller in the Netherlands, 34.7 per cent less in West Germany and about 28 per cent more in France, when compared with Czechoslovakia. Only for grain growing is the profitability level higher in Czechoslovakia than abroad. The average profitability of Czechoslovak crop production comes to about 36.1 per cent, while in West Germany the average is 60.6 per cent and for the Netherlands 70.1 per cent. Finally, on an area unit profit level based on the ratio of the average price for a given artificial fertilizer unit and the return in production, the rate is 3.2 times higher in the Netherlands and 2.8 times greater in West Germany than experienced by Czechoslovak agricultural enterprises. Only France is lower by 16.7 per cent. Thus, most comparisons indicate that Czechoslovak agricultural enterprises generally have less favorable price ratios than other European countries. Adding to the difficulty in recent times has been a further deterioration of the terms of trade for Czechoslovak agriculture.

As a result, even by 1970 various direct state subventions will account for a significant segment of the receipts of the agricultural enterprises, some 22.5 per cent. If one considers the indirect subsidies of various types, the proportion is even larger.

After reviewing this background, Janicek provided the following observation on the current situation in agriculture:

When production cannot be efficiently located and specialized and when producers are not activated for the full exploitation of technical progress, or if progressive technical equipment is not available, food production necessarily becomes more expensive (and its volume is smaller) than under rational economic conditions. In such cases, the means invested in agriculture will not be expediently used for reproduction or for creating conditions for continuous and dynamic growth, but will be used for suppressing and postponing conflicts within agriculture and within agricultural inter-sector relationships.

Once again, the policy makers are caught in a squeeze and generally prefer short-run political answers requiring a minimum of expenditures.

Transportation and Communications

The Ministry of Transportation also submitted its action program covering questions of organization, rehabilitation investments, science and technology, democratization, economic reform and price policy.(45) A number of principles on price policy were set down.

(45) Zeleznicer, 22 May 1968, pp. 7-8.

The transportation rate policy was to be "based on the nationwide economic and transportation policy." Rates were to be set at a level which would "secure to the highest possible extent the reproduction of the development of transportation corresponding to its needs." Finally, the rates were to "reflect the rationalization measures" which would reduce labor expenditures.

Freight rates would be changed for 1969 to such an extent as to assure "the stabilization of manpower and the reduction of work time." Specifically, rates on full loads would be increased differentially according to freight class. Fees on the use of freight cars (demurrage) during loading and unloading would also be increased. After 1970, further increases would be considered, the size of the changes depending on the "possibilities of the national economy." For motor vehicle freight transportation, it is planned to review the tax obligations (e.g., fuel, tires and spare parts) of the Czechoslovak automotive transportation agency (CSAD) before adjusting rates for the period following 1970. The simplification of the tax system by replacing existing taxes with a road tax is also planned. The road tax would be based on the "fair share" of road costs (depreciation) attributable to motor vehicle freight transportation, taking into consideration the planned removal of the turnover taxes on fuel, tires and spare parts. The budget loss of tax revenue from the cancellation of the turnover tax has to be made up. The transportation enterprises would be allowed to make rate adjustments for seasonal variations and to include a rate surcharge on freight traffic transported over underutilized lines.

Before 1970, according to the transportation action program, passenger fare changes would not be general. Here, too, the policy of maintaining the living standard prevails. Thus, the Ministry of Transportation will continue the reduced fares for students and apprentices, and whenever "social" factors are important. Up to 1970, the transportation revenue lost on the reduced workers' tickets which are sold by employees organizations will be covered by state subsidies.

After 1970, a general reform of basic passenger fares will take place. The new passenger rates will be adjusted to include the increased costs resulting from promised wage increments, the reduction of hours, and the revenue losses caused by the sale of reduced workers' tickets. Even after this fare adjustment, the state will still be obliged to "help in the financing of investments." When reducing its dependence on the state budget by increasing fares, the Ministry of Transportation is to do so without damage to "the conceptual development of the standard of living... unless this would mean improvement in the quality of services rendered." This statement indicates the phrase which will be used to justify future passenger rate increases.

In the communications industry, the price problem is more acute. Here, demand is increasing rapidly and the means to service

this growing demand cannot be obtained even with a substantial rate increase. According to a communications engineer:(46)

An increase in the rate of equipment installation (including reserve capacity) for a future, accelerated satisfaction of demand for service requires, in my opinion, employment of subsidies.

Thus, one other sector would continue to receive subsidies beyond the period envisaged for most products or services.

Power and Fuels

Price policy in the power-fuel sector in Czechoslovakia has a number of complexities which not only affect foreign trade but also the unemployment problem in the coal fields. The price relationship established between substitute fuels has a significant impact on both of these problems, and therefore, this factor would seriously circumscribe the freedom to evolve a new price policy for this economic sector. Further, any solution would spill over into other sectors, especially those which are heavy users of energy. In these cases, the economic basis for prices also would be undermined.

Three basic principles concerning price policies in the supply of fuel and power have been outlined:(47) (a) prices should cover costs; (b) prices should remain relatively stable over a long period of time; and (c) domestic prices should reflect the same price ratios found in the world market. The last named principle is especially difficult to adhere to, keeping in mind the relationship of the prices of imported petroleum and natural gas to the price of domestic coal.

Current domestic wholesale prices of the non-solid fuels are derived from the purchase prices of imported fuels set until the end of 1970. These prices are very favorable relative to coal and the Czechoslovak economy has found it difficult, in the long run, to satisfy demand at these prices. It seems that Czechoslovakia will be able to obtain additional quantities of these fuels through imports only at higher prices requiring users to make new judgments. In the future, the central authorities will also have to deal with the problem of imports at variable prices. To bridge this problem, a surtax is to be levied. This surtax could be varied and made high enough to keep domestic demand within import possibilities. These funds "could be the financial source for stimulating the further development of fuel and power, in terms of either their sources or their areas of consumption."

(46) Antonin Hrabe, "What Sources for Financing Communications Capital Investment?" Ceskoslovenske Spoje No. 2, April 1968, pp. 2-4.

(47) K. Prochazka, "Energy Policy of Czechoslovakia," Hospodarske Noviny, 31 May 1968, p. 9.

As domestic coal loses its previous position as the major source of primary energy supply, the problems for this sector increase. At present, the cost level of the coal mining enterprises ranges from 30 to 380 crowns per ton for a given energy unit of fuel. Up to now, the coal wholesale price has, for all practical purposes, been the sum of the individual cost plus transportation cost and includes an average profit rate for the industry. In view of the cost range, a number of coal enterprises enjoyed a large economic rent, which was used to finance the expansion of capacities. In other words, excess profits did not go into the state treasury but were redistributed within the coal industry, thereby avoiding special state subsidies for development. Needless to say, current coal prices are higher than those for imported crude oil and natural gas and will remain unfavorable even "after a possible adjustment of the imported fuels to the level of the free foreign prices." The question remains, how to retain the production of the low-cost coal in the face of the more favorably priced imported fuels. The suggested answer is to raise prices for all fuels, redistributing the "economic rent" received by the more favored fuels. Only the "economic rent" resulting from advantages of location would remain within the coal industry. Then the strip-mining of lignite could still continue. The high cost production in the small basins and underground mines will have to be curtailed. A temporary subsidy from the state budget will be required in order to give time for the buyers of the fuel supplied by the high cost mines to transfer to other fuels and for workers to be retrained.

In the long run, the whole price problem in this sector will be complicated further by the expansion of the production of power through the use of nuclear energy. This problem still has to be faced by the Czechoslovak price policy makers.

Foreign Trade

During the first stage of economic reform in Czechoslovakia, which started in January 1967, a series of selected surcharges and discounts and a "system of internal reproduction compensation of prices" were developed to increase the influence of foreign markets on the internal economy to varying degrees, depending in large part on the short-run competitive condition of the industry and the pressures created by the immediate need for foreign currencies.(48) The effects of the new system were circumvented because of the unexpected changes in wholesale prices. As a result, "in a number of cases, the system operated more as a protection of economic backwardness rather than as a stimulus of progressive production."

(48) Text of the Action Program of the CS Ministry of Foreign Trade, Noviny Zahranicniho Obchodu, Special Supplement, 19 June 1968, pp. 1-16.

The goal set is gradually to eliminate the current protection of production against foreign competition within a five-year period. To accomplish this, according to the Foreign Trade Ministry Action Program, it will be necessary to:

Replace the system of price discounts and surcharges in those cases which are economically justified by a system of temporary subsidies (endowments) which stimulate the development of effective production, by a policy of customs duties, and by a tax policy which would operate in a complex manner, depending on the level of the new rates of the internal compensation of reproduction prices.

The new rates of internal compensation of reproduction prices are to be determined for at least a five-year period so as to enable the enterprise to make medium-term production plans without fear that the state will manipulate the rules of the game to the disadvantage of the enterprise.

The system of bonuses given to reward increases of "effective exports" were to continue at the current level during 1969. The system of surcharges and discounts used to influence machinery imports from socialist countries was to be restricted gradually. The system was to be abolished by 1971. For imported consumer goods, the system of valuation of the foreign exchange crown was to be abolished as of 1969. This system was used to adjust domestic prices of foreign goods depending on the status of foreign consumer goods exchanges. For example, it was possible to raise domestic prices by reducing the value of the foreign exchange crown, thereby raising domestic prices in terms of the crown and reducing demand for consumer goods coming from a particular country. Now there would be added to the foreign price the "usual turnover tax according to the tax rates applicable on the internal market." In this way, domestic and foreign consumer goods will be competing essentially under the same conditions.

During the five-year period when the prices of foreign commodities will undergo a new system of determination, a "realistic rate of exchange" is to be established and a "desirable degree of its convertibility" is to be reached. Simultaneously, the methods applied to calculating costs, taxes and the like are to be harmonized with world practices.(49) These problems and other questions connected with foreign trade are discussed in Section "D" below.

Price Policies of the Government Economic Directive for 1969

Some kind of price policy had to be forged if the preparations for the 1969 plan were to be concluded on time. In early August, the government adopted general principles and outlined the

(49) Vaclav Zahalka (first deputy general director of the Czechoslovak State Bank), "Will the Crown be Convertible?" Hospodarski Noviny, No. 20, 17 May 1968, pp. 1, 4.

direction of change for prices in various sectors. These were published in Hospodarske Noviny. (50)

A number of general objectives which were to serve as a basis for the new prices were outlined. Market formation of prices was to be the general rule to be followed, but with a view to creating equilibrium prices. The new prices were to encourage desirable structural changes in the economy and the prices were to lead to "an intensification of the national economy." Thus, prices were to increase in those areas where "the concept of their [sector] development has been clarified," and where the structural changes would lead to higher labor productivity due to intensive production. However, prices would be stabilized in those sectors where "a concept has not yet been worked out" or where it is unclear how increases in prices would "contribute to the intensification of development."

The document recognized the limitations confronting the Czechoslovak economy in carrying out the general price objectives in 1969. Radical changes in the procurement price system and the economic instruments employed in agriculture could bring about "unfavorable political and social consequences" which should be avoided. The document also noted that existing and intensifying inflationary pressures limited the degree of allowable price changes. Therefore, it was all the more necessary to put into use those economic measures and instruments which would help eliminate these limiting factors and thereby allow the "desirable development of prices" and the "gradual restoration of economic equilibrium."

A number of policy changes were indicated for wholesale, procurement and foreign trade prices. Further individualization of prices, a program adopted for 1968, was to continue. This program followed the product group price method applied for the 1967 price reform, which resulted in some undesirable effects already discussed in the early part of this paper. In determining individual price changes, current supply and demand conditions in the domestic market have to be considered; price relations are to reflect the technical and quality level of the products; and unwarranted differentiation of profitability is to be eliminated. The last of these conditions will not prohibit profitability differentiation based on economic conditions. In differentiating profitability, the practice of redistributing financial resources among enterprises also is to be abolished. The new prices should also encourage the development of "progressive manufactures."

World prices are to provide the upper limit of the domestic price level. Only where the balance of payments prevents this will domestic price departures away from the world price level be allowed.

(50) "Directive," Hospodarske Noviny, 9 August 1968, pp. 1, 8-11.

The proportion of commodities within the various whole-sale price classifications is to be changed. Thus, the limit price category would now include roughly 55 per cent instead of the current 59 per cent of the commodities; the free price category is to increase from the current six per cent to approximately 23 per cent; and the fixed price group is to decline from the current 35 per cent to approximately 21 per cent. Greater price flexibility would result from all these changes.

A number of price policy statements were made in the "Directive" pertaining to specific economic sectors. In the building materials and construction sector, the current investment subsidies were to be abolished and the price level of building materials was to be raised 11 to 13 per cent. Individualization of price changes was to be the pattern, and the changes going into effect on 1 January 1969 were to be made public in October 1968. In housing and public construction, price surcharges for all work would be employed to increase the profitability of this type of construction and a differentiation of the transfers of revenues would also be employed. In some cases, even state budgetary grants to stimulate this type of construction might be utilized.

Since housing rents are not to be increased at least until 1970, the price adjustments for building materials and construction work would require large state contributions for new cooperative housing and higher subsidies for private home building regardless of whether it is done on a do-it-yourself basis or with the help of a construction contractor.

Railroad freight rates were scheduled to be increased 12 to 13 per cent as of 1 October 1968, when the wage adjustments were also to be introduced for railroad workers. "In principle," the higher transport costs resulting from the freight rate changes were to be absorbed out of enterprise income. This was even to be the case for mining, where the price level was to remain unchanged during 1969. The 1969 prices of selected products were to be brought more closely in line with import prices. This would mean an average price reduction of about 0.1 per cent, or a total amount of 50 million crowns.

Machine prices could have been changed if they encouraged the "desirable structural changes." However, the cumulative changes could not affect the price level more than 0.2 to 0.4 per cent of the total sales volume.

In the consumer goods industry, wholesale prices would have to reflect the higher freight rates and higher import prices for cotton. This would require an increase of 800 to 900 million crowns. The new wholesale price increases "must be projected into retail prices" according to market conditions and depending on possible changes in the turnover tax. Furthermore, the adjustment of

the price level, effective 1 January 1968, is also to be reflected in wholesale prices for 1969 in the amount of 120 to 150 million crowns over 1968. Local prices for lumber and some locally produced consumer goods will be introduced in order to reduce the transportation of these items from other areas.

In the food industry possible changes in import prices, the upward adjustment of the railroad freight rates, the introduction of the road tax, the implementation of wage adjustments and the abolition of financial resource redistributions require greater study before the effects of these changes are to be carried down to the retail price level. In the poultry industry, procurement prices are to be reduced to the level of trade prices, thereby eliminating one of the largest subsidies.

In agriculture, only partial adjustments in procurement prices were to be made in 1969. These included a reduction in the prices of poultry, placing of more products in the free price category, and a modification of terms for the delivery of non-contracted quantities. Radically revised procurement prices were to be introduced as of 1 January 1970, and these revisions were to be worked out during 1969. Problems associated with the free selling of feed and harmonizing the production cost prices of imported feed and fertilizer had yet to be solved. Some type of price import policy is to be developed.

As a consequence of the wholesale price adjustments to be carried out during 1969, including the effects resulting from switching commodities to freer price categories, the overall effect on the wholesale price level was to fall within a 1.5 to 2.0 per cent range over the 1968 level.

The directive also recognized that a gradual abolition of retail price subsidies and a shift away from a differentiated to an average turnover tax rate system is necessary for the anti-inflationary policies to work, for the creation of the necessary conditions for the establishment of a convertible currency and for the establishment of market equilibrium for consumer goods. Keeping these ends in mind, the principles of a price policy, which would extend to the beginning of the new five-year plan in 1971, have yet to be worked out. Included in the new proposals will be a revision of agricultural procurement prices and a new system of economic instruments for influencing agriculture; programmatic variants for a comprehensive retail price reform which look into the question of a turnover tax reform pointing toward the elimination of the current tax differentiation practice, and an analysis of price developments during 1968. The last of these studies was to have been submitted in September 1968.

The government economic directives for 1969 reflect the effect of social and political considerations on price policies

and help to explain the reluctance of the government to move more rapidly, particularly in view of the many unsolved domestic and foreign political problems. Subsequent events have only complicated the task, and a new government economic directive has been prepared for 1969.

Harry G. Trend

(Section "B" will be issued separately)

In agriculture, only partial adjustments in procurement prices were made in 1968. These included a reduction in the prices of poultry, raising of more products in the free-price category, and a modification of terms for the delivery of non-contrasted quantities. Partially revised procurement prices were to be introduced as of 1 January 1969, and these revisions were to be worked out during 1968. Problems associated with the free sale of feed and harmonizing the production cost prices of imported feed and fertilizers had yet to be solved. Some type of price import policy is to be developed.

As a consequence of the wholesale price adjustments to be carried out during 1969, including the effects resulting from switching commodities to free price categories, the overall effect on the wholesale price level was to fall within a 1.5 to 2.0 per cent range over the 1968 level.

The directive also recognized that a gradual abolition of retail price subsidies and a shift away from a differentiated to an average turnover tax system is necessary for the anti-inflationary policies to work, for the creation of the necessary conditions for the establishment of a convertible currency and for the establishment of market equilibrium for consumer goods. Keeping these ends in mind, the principle of a price policy, which would extend to the beginning of the new five-year plan in 1971, have yet to be worked out. Included in the new proposals will be a revision of agricultural procurement prices and a new system of economic instruments for influencing agriculture; programs for a comprehensive retail price reform which look into the question of a turnover tax differentiation practice, and an analysis of the current tax differentiation practice. The last of these studies was to have been submitted in September 1968.

The government economic directives for 1968 reflect the effect of social and political considerations on price policies.