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**LENIN AND THE CURRENCY COMPETITION  
REFLECTIONS ON THE NEP EXPERIENCE (1922-1924)**

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# **Lenin and the currency competition**

## **Reflections on the NEP experience (1922-1924)**

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### **Bulgarian National Bank and ICER**

**Summary:** Institutional competition stirs the interest of economists following a certain cyclical pattern. In this context, it is very interesting to look back at the experience of Lenin and the Bolsheviks of adopting monetary competition to stabilize their political and economic power after the crash of the war communism (and the attempts to annihilate money). The currency competition lasts less than two years and ends up with establishing the chervonetz as the only monetary unit. As a whole, this can be considered a successful economic experience. Nevertheless, the main conditions for effective institutional competition were not met – the two currencies were unequally positioned and, what is more, the institutional complementarity principle was not present. Other basic market institutions were lacking or much diminished in functions – mostly the property rights, the principle of free price setting as well as competition in the political and ideological sphere. In general, the NEP model is utterly controversial and its market structure is to a great extent false. This is what actually doomed monetary stability afterwards and left no room for money competition to spread its wings. Despite all these shortcomings, even in its reduced form, the monetary competition, gives a number of positive, though only temporary, results. This reveals the presence of purely technological characteristics of currency competition related to the behavior of money users. In part one we remind briefly of the chronology of events in the first years of the Bolshevik's regime; part two shows the dynamics of currency competition between the soznak and the chervonetz, and in the last part we attempt to draw some theoretical observations related to the necessary conditions for a successful institutional competition.

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## I. Introduction

Economists' interest in institutions, in their evolution and forms follows a certain cycle<sup>1</sup>. The same goes for institutional competition as a main alternative model of consciously constructed institutions. In a broader context this is a question of how credibility emerges, whether this is through competition and choice or through a centralized enforcement.

Roughly speaking, institutional competition means competition and selection of rules of economic behavior, an opportunity for the customer to choose the rules (a choice based on customers' interests). Institutional competition has long been at the center of attention for the Austrian School. Monetary competition is a particular type of institutional competition, which allows the concurrent circulation of two or more different currencies<sup>2</sup>. In order for it to be complete and effective, it is necessary that the different monetary units have equal starting positions and most of all equal legal constraints in order to eliminate initial distortion of the money demand structure. In fact, money competition has always been in place, whether in a complete or in an incomplete form in various configurations and different historical periods<sup>3</sup>. Institutional competition, monetary competition including, has in addition certain requirements that are too often forgotten. Its effectiveness depends to a great extent on the institutional complementarity as well as on the presence of competition in other spheres of the economy and society<sup>4</sup>.

In this context, we find very interesting the attempt of the Bolsheviks and Lenin to use the monetary competition for stabilizing their political power after the crash of the war communism (when there was an attempt to militarize the economy and to abolish a number of fundamental economic institutions)<sup>5</sup>. In the NEP period (1921-1927) there was an attempt to introduce limited market institutions, including stable money – the chervonets. Monetary competition lasts less than two years (11/1922 -03/1924), but it alone gives positive results despite the ideological framework it was wrapped in. Still, the main preconditions for successful competition were not present – there was a lack of equality in the two different monetary units and above all a violation of the principle of institutional complementarity (the absence of an “institutional complexity”). Other basic market institutions were lacking or much diminished in their functions – mostly the stable property rights, the principle of free price formation as well as competition in the political and ideological sphere (here, in fact, the monopoly of the Bolshevik party is even greater than in the war communism period; the red tape is also increasing!) As a whole, the NEP model is extremely controversial and its market

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<sup>1</sup> The reasons for this are various – globalization, technological changes, crash of planned economy etc. This is a topic of a different discussion. Today's debates of the EU functioning and above all of the fiscal competition, the possibilities for institutional competition upon the EU enlargement with the new member countries etc. are examples of the renewed interest in institutional competition

<sup>2</sup> Currency competition in its various aspects has always been at the centre of attention for the Austrian School. It is sufficient to mention the name of C. Menger, L. Mises, V. Smith, F. Hayek, and J. Buchanan as well as contemporary Austrians like R. Vaubel, P. Salin, G. Selgin, L. White, K. Dowd, etc.

<sup>3</sup> For more details see the authors listed in the previous footnote.

<sup>4</sup> Besides, institutional competition is always related to the economic and political interests of certain groups. For more details see Nenovsky and Rizopoulos (2006).

<sup>5</sup> Studying the “ways of entering” the communist economic model provides a valuable information on “ways of exiting” it.

structure is to a great extent ostensible<sup>6</sup>. This is what actually doomed the monetary stability afterwards and left no room for money competition to spread its wings. Despite all these shortcomings it is important to emphasize that the currency competition, even in its reduced form, gives positive results, though only in a short run. This reveals the presence of purely technological characteristics of monetary competition which produce positive effects.

In part one I remind briefly of the chronology of events in the first years of the Bolshevik's regime; part two shows the dynamics of monetary competition between the sovnak and the chervonetz, and in the last part I attempt to draw some theoretical observations related to the necessary conditions for a successful institutional competition.

## II. From the War Communism to NEP – a brief chronology

Between late XIX and early XX century in Russia periods of collapsed public finances and monetary instability (mainly due to wars and social upheaval) (alternated with) (and) periods of attempts at recovery (followed one after another in succession). After the accumulation of sufficient foreign reserves and following some intermediate stages, in 1879 the Gold standard was introduced by law (during S. U. Witte's government (1849-1915)), and thus Russia joined the "golden" (and civilised) countries. The economic reforms extended by Witte (he himself inherited them from A. Abaza, A. Bunge and I. Vishegradsky), were taken further by P. Stolipin (1862-1911) who kept the national money stable and accelerated the agrarian reform (9/XI/1906). As a result of these reforms, the traditional communal peasant municipalities (*mir*) were partly turned into individual private enterprises (it is still arguable today to what extent this was accomplished coercively or voluntarily and evolutionary). The success of these changes was to a certain extent promoted by strengthening the role of a specially created in 1883 Peasant Agricultural Bank (*Krestianskii pozemel'nii bank*), which played a mediating role by buying the land from land owners and granting preferential credit to peasants who wished to use their plots of land individually (as private property)<sup>7</sup>. The social and political climate in early XX century was characterised by an extremely aggressive revolutionary movement, which took numerous victims. The national representative bodies (Dumas created after the revolution 1905) were dissolved several times on the grounds of giving a tribune to straightforward revolutionary ideas.

Russia's involvement in WWI (1914 – 1917) put an end to the monetary stability in the country; the Gold standard was abandoned (with a decree of July the 23<sup>rd</sup>, 1914, 4 days after the war started, which also allowed (contributed to) a fivefold increase of the Gosbank's issuance limits), with money supply escalating (only for 1917 it went up 6 times). Prices were rising, and the Rouble was devaluating uncontrollably. The deep grain crisis of 1916 led to introducing the food apportionment for peasantry (*prodrazverstka*), (this same method was

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<sup>6</sup> The War Communism model (with all the consequences for the coming introduction of the NEP and its characteristics) is most often seen as a coercive or externally imposed by the war political measure (M. Dobb, P. Baran, A. Gerschenkron) or as an implementation of the communist ideas (A. Yugoff, P. Roberts, B. Brutzkus, S. Richman, L. Lih, P. Boettke), or both (A. Nove, E. Carr). The problems of the nature of the War Communism and the NEP are partly considered within the discussion on the possibilities for computing under communism (see Boettke, 1990 for details).

<sup>7</sup> As a result of the agrarian reform, around the beginning of WWI the peasantry owned about 2/3 of the land in European Russia (the remaining 1/3 was owned by the landowners (*pomeshiki*)), Fedorov, 2002, p. 376. The good description of the economic policy (agrarian and industrial) in Russia prior to October revolution is down by Alexander Gerschenkron in Gerschenkron (1976, [1965]).

used subsequently also by the Bolsheviks in the war communism period). In March 1917, Nikolai II renounced his throne and, after a short period of dual power by the caretaker government of Kerenski and the Soviets, the power shifted into the hands of the Bolsheviks' and their leaders Trotsky, Lenin (who had recently returned from Switzerland in the infamous armoured wagon), Sverdlov, Kamenov and others. The ways and reasons for taking over by the Bolsheviks are still disputed today but this is not our subject here. It is an indisputable fact that they radically militarised and centralised the economy for ideological reasons<sup>8</sup> but also forced by reality; a devastating struggle with the white movement (the civil war) as well as foreign intervention took place. After sabotages by employees and technical problems the Emission (Issuing) Bank was taken over by force (on October 28<sup>th</sup> 1917) and turned into a People's Bank, closed down and turned into an instrument of the government for managing the state's finances<sup>9</sup>. The war communism began.

The banking system was nationalized by decree following the Decrees on war and peace, and the Decree on the land. The military principles in the economy and the militarization of labor were applied all over – all enterprises with more than 5 workers were nationalized; about 50 “glavki”, i.e. centralized administrative control of different areas of the economy and the social life were created. Rooted in the belief that “communist society will not know money”, radical actions for the abolishment of money took place. Of course, this happens not through administrative prohibition but through economic means following the laws of quantitative theory of money by purposeful and intentionally uncontrollable issuance, i.e. through increasing the volume of money supply (“a major weapon” against capitalism, if we cite E. Preobrajensky)<sup>10</sup>. The goal pursued in this way was to eliminate the exploiting class (but actually those who suffered were the peasants themselves whose production was purchased at fixed prices). It was considered that an over issuance of money under socialism could not lead to devastating the economy. Here is an illustrative citation of Trotsky's speech at the second congress of the communist international on July the 23<sup>rd</sup>, 1929 regarding the issuance of paper money after the war in Western Europe:

“The issuance of paper money continues to escalate with a growing speed. While in Soviet Russia the growing amount of paper money and their devaluation together with the development of the public economy, the planned redistribution of products and the growing naturalization of the wages emerges only as a result of the decline of “commodity and money relations” in the capitalist countries the growing amount of paper money is a sign of the deepening economic chaos and inevitable collapse”, Trotsky, 2005 [1920], p. 479.

The demolition of money was complete. The monetary supply in this period was exceptionally diverse (Timoshina, 1996): it consisted of Tsarski Roubles (Nikolaevki and Romanovki), Dumski Roubles of different issues, Kerenki – single issues (shaped like newspapers), Kerenki printed by the Soviet government. The Soviet government printed

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<sup>8</sup> Already in “The State and the Revolution” written in 1917 Lenin mentions that the new economic policy will be managed after the principles of the postal service under the control of the armed proletariat (on other occasions Lenin states that the national economy will function as a giant factory or following the principles of a universal moneyless accounting and under a nation-wide control by workers).

<sup>9</sup> The Gosbank was opened in 1920 (its issuing function was executed by a department in Narkomfin of RSFSR).

<sup>10</sup> According to Apostol (1921), p. 884 monthly issues on average develop as follows: November – December 1917 (2 908 mill.r.), 1918 (2 430 mill.r.), 1919 (14 167 mlln. r.), January – February – March 1920 (38 300 mill.r.). The money supply in Ukraine is similar (? postol, 1921, p. 884 -885).

Kerenki until February 1919 and each month up to 2-3 billion unbacked Kerenki entered circulation so as to come up to 2/3 of the total amount of Kerenki in January 1919. Printing speed was “furious”, the mint operated day and night and in the second half of 1919 money printing consumed about 45-60% of the budget revenue. The revenues from printing money (seigniorage) fell drastically. Following the calculations of Preobrajensky, the revenues fell from 2500 mln Roubles in 1917 to 386 mln Roubles in 1919 and 146 mln in 1921 (Katzenellenbaum, 1925, p. 70, and chart 3). Private and local money (monetary substitutes) appeared in many areas in an attempt to overcome the money crisis.

Table 1. Structure of money supply on 1/04/1920

Kinds of money certificates	Volume	% of money supply
Tsartski	21 796	6.4
Dumski	40 358	11.9
Kerenki	46 768	13.8
Soviet emission	230 777	67.9
Piatakovski	221 282	
Exchange certificates	9 495	
Total	339 697	100

Source: Apostol (1921), p. 883

The Rouble quickly devalues against foreign currencies (tabl. 2).

Table 2 Exchange rate of the Rouble against the UK Pound in London for cheques exchangeable in Petersburg (Leningrad) – roubles for 10 Pounds.

	1914 Sept	Oct	Nov	Dec	1915 Jan	April	July	Oct		
Highest	112,5	110	115,2	117	110,5	114,5	135	139,75		
Lowest	122,5	117	118,5	118	117	120	148	144,25		
	1916 Jan	April	July	Oct	1917 Jan	March	April	July	Sept	Oct
Highest	153,5	151,5	155,6	153,5	162	164	162,25	203,6	273,5	311
Lowest	163,75	156,5	157,25	163,5	170	171,5	182	226,5	322,5	377,5

Source: Katzenellenbaum (1925), p. 104

A mass famine in 1921 took millions of victims (5 mil., 20% of the population starves). At the same time expenditure on the war was estimated at 50 billion golden Roubles. The decline in production for the War Communism period (1918 – 1921) is probably one of the deepest declines in the whole Russian and later Soviet economic history (see table 8 in the appendix). War Communism, which makes a practical attempt to replace the coordination through the market and prices with a coordination through bureaucracy and planning (or in

Lenins words – accounting - *uchet*), leads to a complete abolition of the incentives to work<sup>11</sup>. This becomes obvious from the following table 3, referring to the railway industry, where for some lines the rate of absence from work reaches 40% and the absence without acceptable reasons (*progul*) reaches 10%. And also from table 4 which presents the rate of work desertion in Ukraine.

Table 3 Work unattendance rate in 1920 for the railway industry

1920	% of absentees from work for various reasons (total)	% of absentees from work for unknown or unacceptable reasons ( <i>progul</i> )
January	29.8	6.3
February	29.8	5.1
March	28.2	5.3
April	28.8	5.2
May	26.5	4.4
June	23.8	4.3
July	24.8	4.5
August	25.8	5.3
September	25.7	4.6
October	25.3	4.8

Source: Russian Economist (1921), p. 766

Table 4 Work desertion and unattendance in Ukraine for the first half of 1921

Factories	Number of workers beginning of July	% of absentees from work		
		February	March	April
Petrovski	547	17	17	20
Yuzovski	357	30	-	-
Makeevski	4 462	24	32	33
Don- Yurevski	1 921	21	34	31
Luganski	3 565	28	43	43
Harkovski	4 596	31	25	32
Kramatorski	2 028	29	30	31
Druvkovski	1 545	28	33	31
Taganrogski	4 675	23	21	31
Debalcevski	721	38	45	43

<sup>11</sup> According to general estimations (made then and now), after the NEP establishment the red tape was increased instead of decreased which contradicts the basic propagated ideas that the NEP is a radical replacement of the bureaucratic coordination with a market one.

Ekaterinoslavski ?	7 284	45	52	53
B	1 364	21	24	24
Mariupolski	2 466	40	45	54
Konstantinovski	217	20	19	-
Kerchenski	464	-	-	-
Suvinski	1 891	-	-	-
Nikolaevski	3 218	-	-	-

Source: Russian Economist (1921), p. 1427

According to Larin (after Russian Economist, 1921, p. 769) one worker in 1920 produced in average 45% of what he used to produce before the war. In 1920 the loss of working days is as follows: because of factory outage – 68 days, because of sickness – 19 days, for other reasons – 35.5 days and because of holidays – 65 days which leaves a total of only 187.5 working days.

The condition of all social groups deteriorated. Peasants (mainly the middle ones) suffered the ‘price scissors’ (because their products were bought at fixed prices and inflation was high). The working class also suffered<sup>12</sup>. The condition of the army (most of it former peasants) worsened too; the same goes for the clergy. The only class gaining economic advantage during the war communism was the newly emerged and quickly growing bureaucracy – on the state and party level, as well as the speculators-brokers (called *nepman*).

There was an effort to compensate the decline in production with an increase in the labour intensity and overtime working – table 4, but this attempt turned unsuccessful.

Table 5 Overtime working hours in Moscow 1919 – 1920

	% overtime work	Overtime working hours, realized by a worker in a month	Daily overtime working hours
October 1919	15.8	62.8	2.9
November 1919	18.3	62.2	3.9
December 1919	12.7	53.9	2.5
January 1920	25	67.3	3.7
February 1920	14.2	37.8	2
March 1920	17.9	46.8	2.3
April 1920	14.4	37.9	2
May 1920	15.3	68.8	3.4
June 1920	17.9	33.2	1.5

Source: Russian Economist (1921), p. 752

<sup>12</sup> Because the majority of the workers receive their wages in kind they suffer relatively little from the prices growth. According to some western authors we could think of the NEP as of a certain change of the agrarian policy (of the policy towards the peasants) and not of a total change of the economic model (Lih, 1986, 1991).

Social upheavals took place. Peasants and workers went on strike and the climax was the Kronstadt naval rebellion (March 1921)<sup>13</sup> when sailors and red army soldiers mutinied, i.e. part of the Bolshevik revolution's driving force.

It was extremely difficult for Lenin to convince his comrades that a radical change of the economic policy of the war communism was indispensable. The official decision was made in March 1921 at the X congress of the RCP(b) when it was agreed to have reestablished some elements of the market economy and to a certain extent of the private property (for enterprises of up to 20 workers), a foreign capital to be allowed in Russia (in the form of concessions), the *razverstka* to be replaced with a food-supply tax – *prodnalog* (at first a physical – tax in kind, and later, in 1924, a monetary tax)<sup>14</sup> and to introduce stable money. State capitalism entered the discussion together with denationalization, self-supporting running (*hozrashchet*) ect<sup>15</sup>.

The discussion of the principles and methods of introducing a stable currency (money) is very interesting at that time (it is analyzed by Goland, 1991, 1991, 1998, Goland, 2003). To summarize it roughly - the discussion reveals the two main (and well known from the other monetary reforms) approaches to monetary stabilization (monetarists and economists). Those who claim that money should come first and (within this approach it is arguable whether the new money should replace the old money immediately or after a period of competition with the old one) and those who claim that stable money comes after a stable economy. This discussion can be traced in all countries and at the international conferences which try to reestablish the monetary stability lost during the war. At the end of 1921 a special sitting took place where 50 experts offered their ideas of a monetary reform (Goland, 1991).

Among those in favor of starting with the money were Sokolnikov<sup>16</sup>, Kutler<sup>17</sup>, Yurovski, Sheiman, Katzenellenbaum, Kondratiev and others.<sup>18</sup> Their main opponents were Trotsky, Preobrajensky and Buharin (who later on changed his conceptions and in the second half of the 20's defended, together with A. Rikov, adherence to the NEP and was repressed by Stalin as a result). In the context of the monetary discussion other questions were also emphasized alongside the already mentioned (where to start from). These are the fundamental principles about the origin and nature of money, about the backed value of money (gold, energy and labor, bread, index of different goods); as well as technical details (such as the level

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<sup>13</sup> According to Lenin, the Kronstadt rebellion is a cause to rethink a number of suggestions in the past and mostly "the attitude towards the peasantry and the small bourgeoisie" (Lenin, 1977, [1921], p. 237).

<sup>14</sup> It is rarely acknowledged that in general the *prodnalog* is much less of a market mechanism than the *prodrazvertska*, because it leaves less opportunity for choice and that in a way the *prodnalog* is a considerable regress of the market principles compared to the *prodrazvertska*. This reveals the entire controversy of the NEP. The technical details of the functioning of the *prodrazvertska* and *prodnalog* have rarely been the subject of analysis (no such analysis is found in Lenin's speeches or written works). They are best described in Lih (1986), who also provides the most accurate English translation of the respective Russian terms.

<sup>15</sup> Regarding the ration War Communism/NEP see again Lih (1986, 1991)

<sup>16</sup> G. Sokolnikov (1888-1937) is a minister of finance between 1922 and 1926. His monetary stabilization plan dates back to 1918 (one the first to give him that hint was V. Tarnovski). In 1926 he resigns because he disagrees with Stalin's policy of abandoning the NEP. According to Sokolnikov the stable money is the only mechanism which can maintain a relative integration of Russia in the world economy.

<sup>17</sup> N. Kutler, for example, suggests that issuing rights are given to a commercial bank with a foreign capital (Goland 1991). There were also ideas of a direct adoption of a foreign currency (Atlas, 1969). It is remarkable that such an idea is a topic of discussion at all; in more recent times this was seen as extremely heretic.

<sup>18</sup> At the Genoa conference their ideas and suggestions are praised by Keynes who at the time still adheres to the orthodox ideas in monetary policy (supports the gold standard etc.).

at which the exchange rate should be fixed, etc. From the beginning of 1922 the so called “Sovznaki” were introduced (unbacked money); their issuance was renewed in 1923 (at the rate of 1 new sovznak = 100 sovznak emission 1922) along with the issuance of backed money – Chervontsi (7.74 gr. pure gold = 10 pre-Revolutionary golden coins)<sup>19</sup>. Chervontsi were backed 25% with gold and currency (which was itself backed with gold) and 75% backed with liquid assets (bills etc). While the sovznaks were issued by the government, the chervontsi were issued by the reinstated central bank - Gossbank (by the way its balance sheet was divided into two parts, similar to the other central banks at that time – issue and banking balance sheets published every two weeks in the newspapers).

During the whole 1923 and the beginning of 1924 the sovznaki and the chervontsi were in parallel circulation, while attempts were made to artificially separate their circulation<sup>20</sup>. The chervonetz entered the international currency markets and its credibility increased. The prohibition to finance the Soviet government budget with chervontsi contributed to its higher credibility. The budget was financed only by sovznaki (in October 1923 the chervontsi are already  $\frac{3}{4}$  of the money supply therefore it is decided against their further emission). In 1922 the government succeeded to realize the first internal wheat loan which contributed to increasing its credibility. In this period the chervonetz’s price appreciated against the sovznak and other currencies (mainly the US dollar) which were attributed to the Gossbank’s interventions. Prices of goods calculated in sovznaki were rising while prices in chervontsi were going down. In March 1924 after the sovznaki were intentionally devaluated (again by increasing their amount) and were repurchased at a rate of 50000 rubles for one golden ruble, the chervonetz became a convertible currency (its exchange rate was fixed to the gold). From March 31<sup>st</sup> the chervonetz became the sole currency and the monetary stabilization was complete<sup>21</sup>.

Unfortunately, the currency stability did not last long. After Lenin’s death (January 21<sup>st</sup> 1924) money became the pledge of different conflicts within the society and the party (for example Bukharin and Rikov were firm adherents to continuing the NEP), which will be discussed further on. The wheat crisis of 1925 and subsequently of 1926 put an end to the currency stabilization and following a few measures the dominating political ideas were again those of forced industrialization and strengthening the role of the state at the expense of the private sector and the market. Speculators and *nepman* – became known as enemies and threats to socialism, and turned into a target of political pursuits (*nepmani-lovkatchi*)<sup>22</sup>. It is necessary to note that as back as 1925 the monetary supply began to grow following the

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<sup>19</sup> This happens for the first time on 12/10/1922. The Chervonetz faced a resistance and Lenin (who was undergoing a medical treatment at this time) often asked why they were not yet in circulation. The original idea was to name the currency *Federal*, *Tselkovii* or *Grivna* instead of Chervonetz. Different nominal golden Chervonetz entered circulation featuring a peasant and a female worker with the motto “Proletarii from all countries, unite!”. For the history of Chervonetz issuance and their design see the extremely interesting book by Gleizer, 1993, [1978].

<sup>20</sup> According to Goland “persons of influence want the Sovznak to be preserved as a source of emission revenue...and they do not want to introduce chervontsi with a small nominal value” (Goland, 1991, p. 62).

<sup>21</sup> In 1924 all kinds of private money and monetary substitutions, widespread until then, were banned. (For details see Gleizer, 1993). In a way, the establishment of the Chervonetz was by force and by limiting the free initiative in the monetary sphere, t. e. limiting the currency competition!!

<sup>22</sup> For details see Goland (1998).

credits to the government granted by the Gossbank which decreased the backing of the chrvonetz (see table 6 )<sup>23</sup>.

It is important to note that while elements of economic liberalism emerge during the NEP period, the political sphere is characterised by increased monopoly of the Bolsheviks and the repression against the different-minded (it can be claimed that the retreats of the Bolsheviks in the economic sphere are compensated with strengthening their political positions, while in fact the reason for the retreat is preserving the political authority).

How in fact is the currency competition revealed in such a short period?

### III. Currency competition – sovznak against chervonetz

Two basic features distinguish the monetary reform during the NEP period<sup>24</sup>. Firstly this is the search for monetary stability through pursuing convertibility and an exchange rate fixed to the gold, and secondly, this is the establishment of that stability as a choice of the money users. The first can be called a search for credibility from the top, from a political decision; the second is a search for credibility from the bottom – from the economic actors.

Besides, in general, the competition between the two types of currency – the chervonez and the sovznak, can be viewed as an institutional competition, as the first were issued by the Ministry of Finance (*Narkomfin*) while the second – by the reestablished central bank. The first was unbacked currency, while the second possessed the characteristics of a fixed by law backing at an exact exchange rate<sup>25</sup>. And fourth, it is very important to recognize that the currency competition is limited and to a great extent sought by the Bolsheviks; it has certain goals, namely to sink the debt accumulated in sovznaks (through the debt devaluation) and begin from a clear start. This is also proved by the fact that the sovznaks' devaluation is intentionally sought through the issuance of big volumes of this currency. The administrative and legal division of the spheres of circulation of the two currencies was kept during the whole period (to a different extent of course), up until the complete establishment of the chervonetz. In this case the free float also reflects these artificial constraints on the currency choice.

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<sup>23</sup> The economists of the Conjunction Institute (N. Kondratiev) constantly signaled the negative effect this would have but they were ignored for various reasons. (see also Johnson and Temin, 1993, according to whom this finally turns the terms of trade against the peasantry – just the opposite of what was pursued by the Bolsheviks).

<sup>24</sup> Katzenellenbaum(1925) presents data on the dynamics of the monetary supply (in its different components), inflation, exchange rate, as well as a number of different monetary variables. Zaharii Solomonovich Katzellenbaum (1885 – 1960) graduates from the Moscow University in law and economics, as an author of a number of books on monetary theory. As a member of the Governing Council of the Gossbank, his signature stands on a great part of the issued Chervontsi. One of the few if not the only member of the Gossbank government who died a natural death, i.e. he was not repressed by Stalin (Gleizer, 1993, [1978]).

<sup>25</sup> As I mentioned, the Gossbank's balance sheet was divided into two – banking and issuing departments. This imitates the way the Bank of England organizational structure. Today this structure can be seen as similar to some currency boards in Eastern Europe, for example Estonia and Bulgaria.

The dynamics of the monetary supply's structure, which shows how the chervonetz replaces the sovznak, can be seen on the table below. The maximum is reached in March 1924 when the chervonetz constitutes almost 84% of the monetary supply.

Table 6 Dynamics of the monetary supply January 1923 – October 1924

		Amount of Chervontsi transferred to the bank by the bank Issue Department (in thousands)	Precious metals and stable foreign currency covering the issue of chervontsi. Percent	Amount of treasury issues in circulation "Sovsnaks" in mlns of Rubles	Percentage of chervontsi in circulation to the total amount	Bank's possession of gold and foreign currency in Russia and abroad (in thousands of chervontsi)
1	1923	1,118	97,7	1,994	3	3,148
2		1,93	78,9	2,629	6,3	4,193
3		3	66,2	3,236	10,6	5,132
4		4,5	61,9	4,482	14,8	6,486
5		6	63,8	6,076	22	7,384
6		8	53,6	7,051	27,7	7,558
7		9,6	55,3	9,032	37	9,154
8		13,5	50,1	12,4	50	11,573
9		18,4	51,4	15,136	66,5	13,664
10		23,5	50,9	22,702	79	15,853
11		25,45	50,2	53,593	74,4	16,569
12		26,766	50,4	98,839	75,4	18,556
1	1924	28	51,2	178,51	78,3	21,353
2		30,3	50,7	333,018	83,7	24,655
3		32,8	51	866,504	82,2	27,128
4		33,8	51,3	768,101	75,1	30,113
5		35,2	53,4	740,236	67,6	31,086
6		36,7	53,3	-	60,5	31,869
7		38,75	51,9	-	60,9	30,346
8		41,75	50,1	-	57,6	31,355
9		46,156	46,8	-	56,9	31,314
10		51,887	44	-	55,7	30,498
11		-	-	-	-	32,649

Source: Katzenellenbaum (1925), p. 104, p. 176.

The "victory" of the chervonetz is evident from the dynamic of the price indices, denominated in sovznaks and chervonetz respectively; from the exchange rate between the two

currencies (which is a floating one) as well as from the stabilization of the chervonetz exchange rate towards the dollar and the pound <sup>26</sup> (table 7).

Table 7 The exchange rate of the chervonetz at the Moscow Exchange at the beginning of every month and Purchasing Power of the Chervonetz

		Exchange rate in Soviet (1923 issue) roubles	Exchange rate in UK Pounds (parity - 1.057)	Exchange rate in US Dollars (parity - 5.14)	Purchasing Power of the Chervonetz in revised wholesale index prices of the Gosplan	Purchasing Power of the Chervonetz In detail prices index of the Inst. Of "Econ. Conjunction"
12	1922	117	1,17	5,087	-	-
1	1923	175	1,219	5,426	10,4	6,99
2		209	1,259	5,186	9,62	6,8
3		239,5	1,128	5,206	8,63	6,29
4		302	1,168	5,206	8,7	6,45
5		457	1,033	4,408	9,18	6,71
6		570	0,856	3,851	7,92	5,59
7		760	1,02	4,662	6,88	4,87
8		1120	1,037	4,765	6,32	4,41
9		2000	1,047	4,591	6,36	4,79
10		4000	1,066	4,878	6,39	5,24
11		7000	1,093	4,827	6,7	4,48
12		13700	1,055	4,594	6,36	4,81
1	1924	30000	1,064	4,545	5,92	4,18
2		82000	1,085	4,608	5,36	3,89
3		300000	1,103	4,739	5,18	3,88
4		500000	1,196	5,141	5,53	3,97
5		-	1,174	5,141	5,71	4,39
6		-	1,193	5,145	6,03	4,46
7		-	1,189	5,141	5,91	4,52
8		-	1,169	5,141	5,7	4,26
9		-	1,145	5,141	5,8	4,24
10		-	1,152	5,141	6,09	4,55

Source: Katzenellenbaum (1925), p. 108, p. 111

The chervonetz' convertibility at a number of European markets (in China, Italy, Austria, USA, Japan, Germany, Iran and Turkey) brings about a symbolic rhyme which the working men of USSR use to appraise the international role of the currency:

<sup>26</sup> The analysis of the currency substitution and in general of the hyperinflation period in Russia has been undertaken by Bernholz (2003), as well as Cagan (1956), within his famous model of money demand.

*„Britt, frantsuz, poliak, iaponetz,  
 Ochelomlenii vpolne,  
 Chto okrep uje chervonez  
 V proletarskoi storone.  
 Zagranichnie bankirii  
 Uje stali uveriat’  
 Chto Chervonnoi im Rossii  
 Nevozmojno ne priznat’”, Gleiser (1993, [1978])*

“The Brit, the Frenchman, the Pole, the Japanese are stunned completely,  
 That a chervonetz of the proletarian country became already firm  
 Foreign bankers began even to assure that there is no way not to recognize a Pure  
 Gold Russia”, Gleiser (1993, [1978]), my translation.<sup>27</sup>

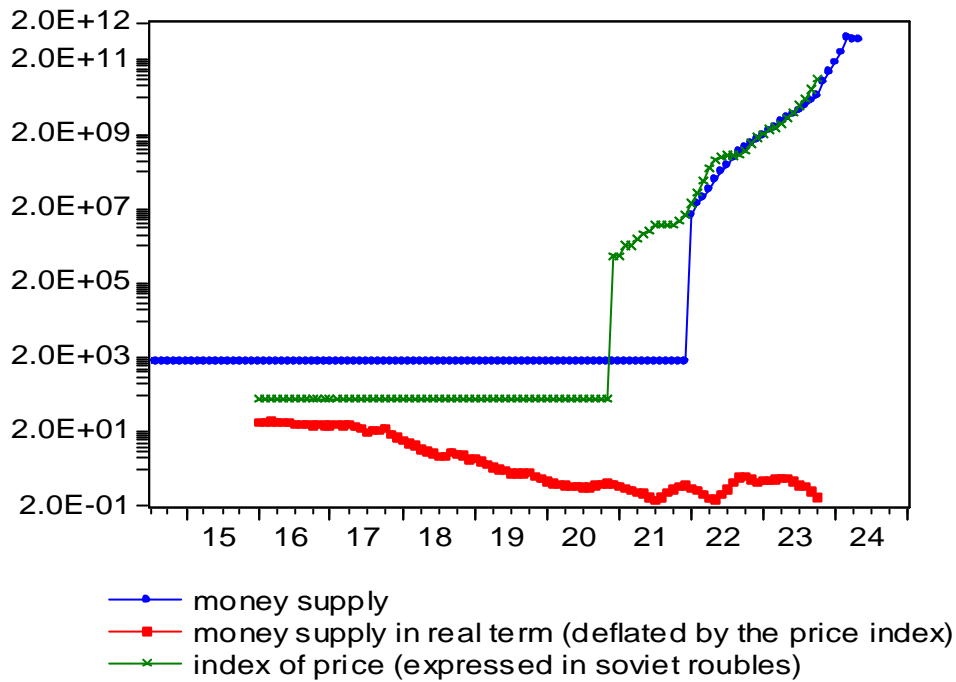
Thus through the currency, Russia succeeds to return (at least partly) to the world economy. Subsequently, sooner rather than later, the chervonets’ quotation was terminated in 1926 because its export was banned and in 1928 the ban included its import. This quick change is in line with the general tendency of undermining the monetary stability (together with the issuance of unbacked money in 1925) and limiting the NEP.

#### Graph 1

Dynamics of the monetary supply, the price index and the real monetary supply (1914 – 1924) – logarithmic scale

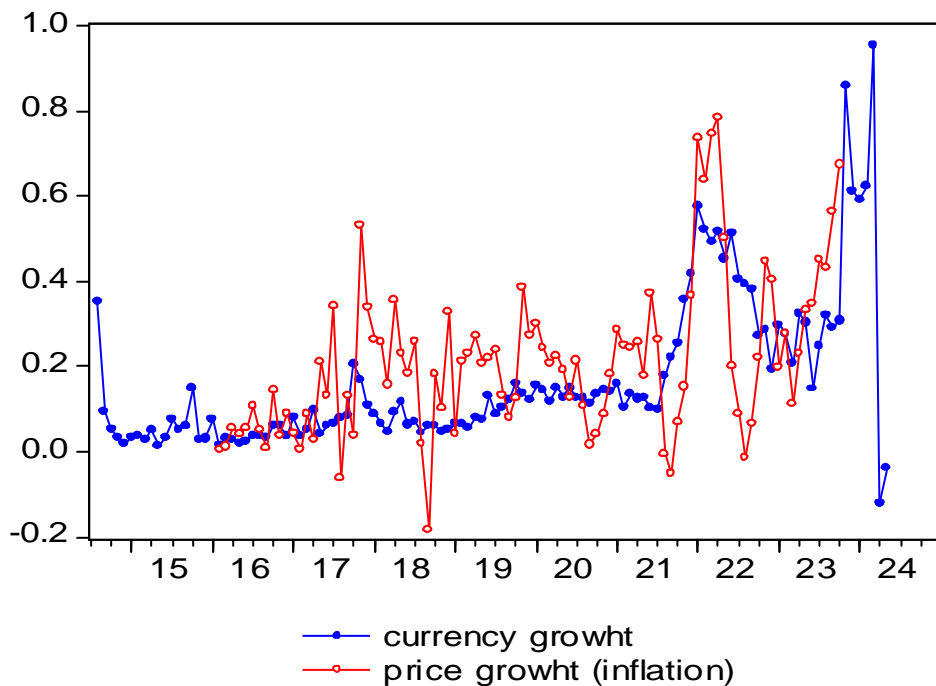
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<sup>27</sup> It is interesting that international official recognition of Bolshevik Russia takes place in 1924 when the Chervonetz was finally and fully established.



Graph 2

Currency and price growth (1914 – 1924 ?.) – normalized scale

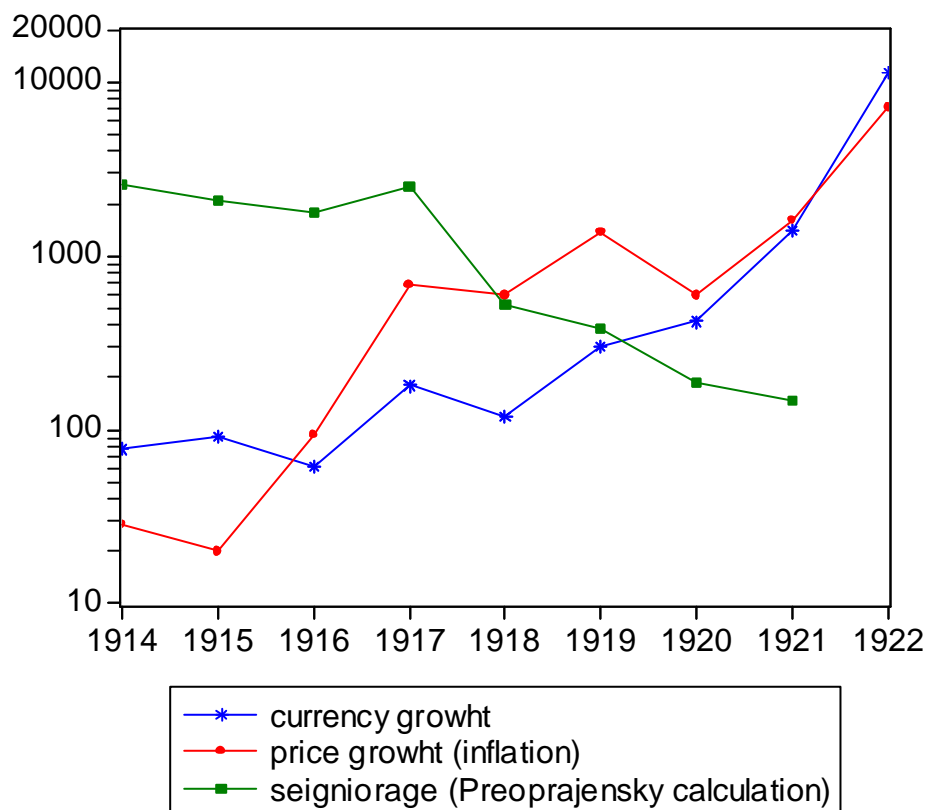


Due to the high values of the variables after 1921 – 1922, when the money was intentionally “annihilated”, graph 1 cannot present the monetary base growth in the period until the beginning of 1922 and the price index until the beginning of 1921 (they look like a straight line). There is no doubt that before 1921 – 1922 the currency in circulation and the prices rise. This can be partly

observed from the curve of the monetary supply in real terms as well as from graphs 2 and 3. It should also be acknowledged that in the first years of the war communism the monetary base actually shrinks because the money is replaced by exchange in kind and central planning but also by various private money and currency substitutions, which are not counted in the official statistics. This is partly observed on graph 3 which presents a very small currency growth until 1922. It can also be inferred that inflation presupposes and later overrates the currency growth rate. Graph 3 shows the abrupt decline of the Soviet government's monetary income (seigniorage) and its money evasion which is also one of the main reasons for introducing the chervonetz.

Graph 3

Annual growth of the monetary supply, prices and seigniorage (calculated by E. Preobrazhensky), 1914 – 1922, logarithmic scale



Let us now see what the short Soviet experience in monetary competition can contribute to the analyzing and implementing of currency and institutional competition in general.

#### IV. Instead of a conclusion: what this experience tells us?

Firstly, in order to be successful, each institutional competition needs to develop within the framework of a general competitive economic model, which requires the presence and overall functioning of a number of basic institutions – above all property rights, private initiative, free price-setting etc. In other words what is needed is a certain minimal level of institutional complementarity<sup>28</sup> and at least a minimal institutional coherence that would allow currency competition to flourish (i.e. a stable credibility of the currency)<sup>29</sup>. The NEP’s economy does not embody these characteristics neither in its economics nor in its political and ideological sphere. The lack of an institutional system in the NEP’s economic policy meant “The Bolsheviks thought they could pick and choose elements of a market economy” (Johnson and Temin, 1994, p. 765). Despite the evidence of Lenin’s citations (where he claimed that the NEP was “taken seriously and meant to last long”), or the later Bukharin’s concordant claims, even they did not see the NEP in general as a radical break off with the War Communism and as introducing a model of competition and market economy<sup>30</sup>. This is evident from even the most basic economic data, which shows that in the moment when the Chervonetz becomes the only legal tender in 1924 the private sector begins to shrink in all its spheres (in fact it has never exceeded 25% of the economy). The dynamics of production is shown on table 8. The fact that in retail, where the private sector was 75.2% of the turnover in 1922 - 23, it sinks to 22.4% in 1927 – 28, speaks for itself (Bandera, 1963, p. 269). The excess issuance of money, the credits to the government granted by the Gosbank and the sudden reduction of the backing of the Chervonetz began as early as 1925. At this time the Soviet economy, in spite the declarations remained a closed economy (in both its trade and finance flows), the quick loss of convertibility of the Chervonetz has already been mentioned.

Table 8

Gross Industrial Output According to the Type of Ownership (in %, at Prewar Prices)

Period	State	Cooperative	Private and Concessionary
1923-24	70.3	5	24.7
1924-25	72.2	9.1	18.7
1925-26	74.7	9.0	16.3
1926-27	77.1	8.8	14.1

Source: Bandera (1963), p. 268 (data are from: Segal, L., B. Tal (1929), Economic policy of soviets’ government, Moscow and Leningrad, p. 165)

The inconsistency of the NEP economic model (some call it a “hybrid model”) is well formulated by V. Bandera who otherwise pleads for building a “hybrid model of socialism”:

<sup>28</sup> Part of the principles of institutional complementarity can be derived within the framework of the theory of systems, from the necessity for their synergy etc.

<sup>29</sup> The principles of institutional complementarity have not been the subject of in-depth theoretical analysis, though some interesting publications can be found (for example the book by Aoki, 2000).

<sup>30</sup> For details see Lih (1986, 1991). According to Lih (1991), Bukharin used to accept that a competition could exist only between socialism and capitalism and he never accepted competition within socialism itself (p. 247-248). In fact he does not evolve much from his earlier positions, when he analyses War Communism (see Bukharin, 1989, [1920, 1928]). On Stalin’s views, who in fact never liked the NEP, see Himmer (1994). Trotsky’s views are clear- he was against the NEP.

“As under perfect competition, the private sector had to accept prices as given parameters; but unlike conditions under perfect competitions, prices were not primarily determined by the market. Furthermore, the preponderance of state monopolies in the economy greatly restricted the scope for private initiative and created an atmosphere of uncertainty for atomistic decision units. The restraints on private initiative without doubt prevented numerous socially desirable activities from being undertaken by the private sector. [...]. The conditions of production and exchange during NEP may be summarized as follows. The state was preponderant in certain industries and, hence, was able to undertake structural adjustments according to the preferences of ruling elite. The private sector, which controlled limited resources except in agriculture, could make only marginal adjustments”, Bandera, 1963, p. 275.

The second important feature (besides that it functions within a general non-competitive environment) is that the currency competition between the sovznak and the chervonetz is partial, limited and to a great extent manipulated (especially in its beginning). In fact the introduction of the chervonetz was dictated by purely political and pragmatic goals (retaining the power, improving the conditions of the peasants mainly, establishing the new political power internationally, improving the opportunities for foreign borrowing etc.). But in fact the Bolsheviks' hostile attitude towards money remains, other elements of private property were also disdained (despite the slogans “Get rich!”). In particular, mainly at the beginning of the parallel circulation of the currencies, their spheres of usage were divided, the sovznaks circulated in the public sector while the chervontzi operated in the private and informal sectors. Interestingly, the way currency competition was manipulated (at least in the beginning) is revealed in the following: while the government debt denominated in sovznaks devaluated quickly, the income from taxes was legally binded in chervontzi. Whether or not this was an intentionally created demand for money, it confirms the hypothesis that currency competition was in a way a temporary solution to the Bolsheviks' problems with their internal debt and public finances (the political tasks were mentioned before). The period of currency competition was very short (17 months) and ended with declaring the chervonetz' monopoly. In fact, for a (certain) competition to be successful (in this case institutional competition) it needs to be continuous! Or, if a (certain) currency has been established by the choice of its users, it is necessary that this currency be subject to a potential new competition, t. e. the market for monetary institutions to be open.

Thirdly, it is important to emphasize that despite all its imperfections and limitations the parallel circulation of the sovznak and the chervonets show that there are certain intrinsic technological mechanisms which can function (to a certain limit!) regardless of the institutional background and ideological environment. It comes down to the principle that the credibility of the currency (as well as of any given institution) is a result of comparison with an alternative currency. The money users (national or supranational money) always choose the money with the most stable purchasing power. They choose the kind of money which is less manipulable by politicians and which is subject to stricter rules of issue (a legal convertibility and backing with a certain stable foreign currency). The credibility in certain monies and in the monetary discipline is ultimately granted by the consumers of money and monetary services and not by decrees of the relevant centralized authorities.

Annex Table 9

Dynamics of the main variables in Russia during the crises, observed in the period 1905 – 1997

In %, % change minimum (% change maximum)

	National product	Agrarian Economy			Industry		Transport		Investment in fixed capital
		total	Plant-growing	Farming	Total	Consumption goods	Cargo-carrying	Passengers'	
1905-1906	-10 (-15)	-15 (-20)	-20 (-25)	-5 (-10)	-5 (-10)	-	-5 (-10)	0 (-5)	-20 (-30)
1916-1917	-20 (-25)	-10 (-15)	-20 (-25)	0 (-5)	-25 (-30)	-30 (-35)	-20 (-25)	-10 (-15)	-
1918-1921	-45 (-50)	-30 (-35)	-35 (-40)	-25 (-30)	-70 (-75)	-50 (-55)	-75 (-80)	-50 (-55)	-75 (-85)
1932-1933	-5 (-10)	-30 (-35)	-20 (-25)	-50 (-55)	+10 (+5)	-5 (-10)	0 (-5)	-10 (-15)	-10 (-20)
1940-1946	-30 (-35)	-50 (-55)	-55 (-60)	-45 (-50)	-30 (-35)	-45 (-50)	-35 (-40)	-45 (-50)	-40 (-50)
1990-1991	-10 (-15)	-5 (-10)	-5 (-10)	-5 (-10)	-5 (-10)	-5 (-10)	-10 (-15)	-10 (-15)	-10 (-20)
1992-1997	-40 (-45)	-30 (-35)	-20 (25)	-40 (-45)	-50 (-55)	-55 (-60)	-45 (-50)	-35 (-40)	-65 (-75)

Source: Poletaev (2001), p. 222

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