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Soviet Banking and the Planned Economy:
Some Recent Changes

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Paul Gekker

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Introduction

The Soviet Union in recent years has adopted important measures affecting the operation of two key areas of its planned economy: the management of Soviet industry, and changes in the programs and policies of agriculture. These interesting modifications have attracted considerable attention in the West. However, recent changes in Soviet banking, primarily in the position and functions of the Soviet central bank, have largely gone unnoticed outside the Soviet Union.

In October, 1960, the State Bank of the USSR received a new basic statute which incorporates the changes in its status and functions introduced in part in connection with more important reforms in Soviet industry and agriculture. The new statute is the first revision in basic central banking legislation since the end of 1949. In many important respects, it merely reaffirmed the position and status, as well as the conventional central banking functions, which the State Bank already possessed under the 1949 statute. It also covered legislative measures adopted in the intervening period. However, the October 1960 statute is significant because it incorporates the additional functions which the State Bank acquired as a result of the basic reorganization in mid-1959 of the Soviet banking system.

In July, 1959, certain specialized Soviet banks, engaged primarily in the financing of long-term investment, were liquidated and their functions divided between the State Bank and one remaining long-term bank, which was reorganized as the Investment Bank. In the process, the State Bank was transformed from an institution concerned almost exclusively with short-term lending operations to one performing a mixture of short and long-term banking functions. The State Bank was also given responsibility for lending operations for a much wider area of the economy than it exercised prior to mid-1959, especially in the field of agricultural finance. With the acquisition of responsibility for an important share of long-term investment financing from the liquidated special banks--a function it now shares with the Investment Bank--the State Bank also assumed new supervisory and regulatory powers. The banking reorganization of 1959, therefore, marked a significant enhancement of the control authority exercised by the Soviet central bank in the specific areas of investment and agricultural finance.

Despite the interesting changes in the banking system brought about in 1959, their effect is likely to be limited. The chief role of Soviet banks, in their capacity as control agencies of the central authorities, is in reality a passive one. The attention of Soviet planners and economic officials generally is focussed on the attainment of physical output goals, so that financial criteria tend to be accorded less importance in practice. This suggests that, with all its enhanced powers of control, the State Bank will not be entirely successful in eliminating those inefficiencies in the Soviet system which stem from violations of accepted standards of financial performance on the part of its clients.

* This article was prepared specifically for the use of a group of American bankers scheduled to attend the 15th International Banking Summer School in Moscow in July, 1961. It is expected that Mr. Gekker will be a member of the group.

Banking Reform and the 1960 State Bank Statute

The 1959 banking reform

Reorganization of the Soviet banking system was authorized by a decree of the Presidium of the USSR Supreme Soviet, dated April 7, 1959. This measure provided for the liquidation, on July 1, 1959, of two of the three existing special banks for long-term investment--the Agricultural Bank (Selkhozbank) and the Central Communal Bank (Tsekombank), along with local communal banks. Their functions were divided between the State Bank of the USSR (Gosbank) and the third long-term institution, the Industrial Bank (Prombank). In the process of reorganization, the Industrial Bank was renamed the Investment Bank, or Stroibank. A decision of the USSR Council of Ministers, supplementing the reorganization decree, provided a three-month period for winding up the affairs of the two liquidated institutions, and for the submission by the State Bank and the Investment Bank of draft statutes incorporating the changes in their status and functions resulting from the reorganization.

For some years prior to the 1959 reorganization there were four banks for long-term investment in the Soviet system. In addition to the Agricultural Bank and the Central Communal Bank (both liquidated in 1959) and the Industrial Bank (reorganized as the Investment Bank), a fourth institution--the Trade Bank (Torgbank)--ceased operations as of January 1, 1957. At that time, its functions were divided between the Agricultural Bank and the Central Communal Bank.

Distribution of banking functions--Prior to the reorganization of mid-1959, a clear distinction could be drawn between those functions performed by the State Bank of the USSR, on the one hand, and the special banks for long-term investment, on the other. The State Bank was the source of virtually all short-term credit in the Soviet economy, and this comprised its principal banking function. The State Bank still retains this position.

As their name implies, the special banks for long-term investment (banki dolgosrochnykh vlozhenii) concerned themselves primarily with the financing of capital investment, which was accomplished either by means of non-repayable grants from the Soviet budget, or by long-term loans.

Some relatively minor exceptions to this distribution of responsibilities in the fields of short and long-term credit may be noted. While the State Bank was primarily engaged in the extension of short-term credit to finance working capital requirements of one sort or another it could, in certain cases, provide financing for a portion of the permanent capital of an enterprise. In addition, the State Bank extended special intermediate-term loans directly to enterprises to finance modernization projects, the acquisition of improved technology, and related purposes. These functions are retained at the present time.

There was also one exception to the special banks' primary function of disbursing non-repayable investment funds allocated from the Soviet budget.

It was these banks, rather than the State Bank, which extended short-term credit to construction enterprises engaged on projects for which they disbursed the investment funds. Continuing the practice of its predecessor institution (the Industrial Bank) and of the other banks liquidated in 1959, the Investment Bank now has this function of extending short-term credit to enterprises working on the construction of investment projects for which it handles the budget grants. This short-term lending activity remains, therefore, the sole exception to the virtual monopoly over short-term credit enjoyed by the State Bank.

From the foregoing, it will be seen that the 1959 reorganization did not change the basic division of responsibilities in the field of short-term banking operations. The banking reorganization is important because of the division introduced in the responsibilities for long-term banking activities. The present position is that both the State Bank and the Investment Bank handle capital investment financing, i.e., both institutions disburse funds allocated from the government budget for investment in the State-owned sector, with each bank engaging in these operations in designated branches of the economy. Both institutions also extend long-term loans outside the State-owned sector, in the branches of the economy which they service.

Two principles appear to have been followed in distributing responsibility for these two forms of long-term banking operations between different branches of the economy and between the two institutions which now comprise the Soviet banking system. One distinction is between the financing of agriculture (including the State-owned sector of agriculture) and other lending activities outside the State-owned sector (this comprises largely the cooperatives), on the one hand, and the financing of investment in all other State-owned sectors--industry, domestic trade, transport and communications, etc.--on the other. The second distinction appears to be between financing and lending operations servicing activities in urban areas, and those in rural localities (or serving the rural population).

State Bank functions--In accordance with these principles which apparently govern the present distribution of banking functions, all budget financing and long-term lending in the field of agriculture have, with one very minor exception, been entrusted to the State Bank. Thus, the State Bank disburses budget allocations for investment in the State-owned agricultural sector--by state farms, tractor repair stations, and the like. The State Bank also extends long-term loans to collective farms; and the central bank has also been given the important function of encouraging the deposit by collective farms of that portion of gross income which should be set aside for the partial financing of capital investment. As in the past, the State Bank still controls the deposit and the expenditure of funds, earmarked for the maintenance and repair of capital assets, by state and cooperative enterprises; this includes capital repairs and maintenance for enterprises in industry, agriculture, housing, trade and transport. Among its remaining functions, the State Bank is responsible for budget financing of investment in the municipal and communal sectors, except for State-owned and cooperative housing construction; for long-term lending to cooperatives; and for the financing of schools, hospitals and similar installations, as well as for long-term lending for individual housing construction, in rural areas.

Investment Bank functions--The Investment Bank is charged with responsibility for all budget financing in the field of industry--a function acquired from its predecessor institution, the Industrial Bank--as well as for budget-financed investment in domestic trade, transport and communications, and State-owned housing construction. It is thus responsible for all investment financing functions in the State-owned sectors of the Soviet economy with the sole exception of State-owned agriculture. The Investment Bank is entrusted with control over the accounts and the expenditure of funds for capital repair and maintenance by contract organizations in the construction field, organizations engaged in geological survey work and similar activities, and of some other miscellaneous types. Among other functions, the Investment Bank finances cooperative housing construction; and it is also responsible for financing the construction of schools, hospitals and similar projects, as well as for long-term lending for individual housing construction, in urban areas.

Present banking structure--The transfer to the State Bank and the Investment Bank of the functions of the special banks liquidated in 1959 resulted in an overall reduction in bank offices. The available data for selected postwar years are shown in the following table.

Soviet Banking Offices, Selected Years

<u>End of Year</u>	<u>State Bank System</u>	<u>Other Banks</u> ^{1/}	<u>Total Offices</u>
1946	4,265	1,009	5,274
1951	4,994	1,127	6,121
1956	4,861	1,200	6,061
1957	4,760	1,075	5,835
1958	4,649	1,071	5,720
1959	4,270	446	4,716
1960	4,213	468 ^{2/}	n.a.

^{1/} Special banks only; excludes offices in savings bank system.

^{2/} As of July 1, 1960. In addition to these 468 offices of the Investment Bank, its representatives are located in 444 local offices of the State Bank, presumably in localities in which there are no local Investment Bank offices.

Source: End-of-year data (through 1959) from Vestnik statistiki, February, 1960, page 85; December 1960 data (State Bank offices) from Dengi i kredit, XIX:2 (February 1961), page 30; data on Investment Bank offices (July 1, 1960) from P.D. Podshivalenko and I.D. Sher (editors), Finansirovanie i kreditovanie kapitalnykh vlozhenii (Moscow, Gosfinizdat, 1960), page 33.

Between the end of 1956 and December 1957, the total number of bank offices was reduced by 226, with the decline of 125 special bank offices reflecting primarily the liquidation of the Trade Bank, which had 122 offices at the beginning of 1956. By December 1958 there were 5,720 offices, a slight reduction of 115 from the previous year-end total. After the mid-1959 reorganization, however, there was a substantial reduction in total bank offices, which declined by about 1,000 as compared with the total in operation at the end of 1958. The greatest reduction took place in special bank offices, the 1,071 offices of the three long-term banks being reduced to 446 Investment Bank offices. There was also a drop--by 379 offices--in the number of State Bank offices after July 1959. The total number of bank offices in operation at the end of 1960, approximately 4,700, represented a decline of a little less than one-fifth in total offices in the Soviet banking system in two years.

The post-reorganization reduction from about 1,000 special bank offices to the 450-odd offices of the Investment Bank was accomplished by consolidating offices of the special banks in localities in which offices of more than one of these banks was previously in operation. The change in State offices is not so easily explained, although it is likely that, despite the fact that the State Bank probably absorbed the 300-odd offices of the Agricultural Bank, the reduction in State Bank offices reflected the closing of some branches and the consolidation of others.

The reduction in bank offices after July 1959 coincided with a general objective of the Khrushchev regime in seeking, in a number of fields, a measure of administrative simplification, the elimination of over-lapping areas of jurisdiction and of duplicating facilities, a reduction in the government "apparatus," and the realization of some budgetary savings.

It had long been the case that a sizeable share of the financing and lending operations of the long-term institutions was carried out by branches of the State Bank located in places in which there were no branches of the special banks. At the beginning of 1956, for example, the Industrial Bank had only 355 offices and branches, the Agricultural Bank 450, the Trade Bank only 122, while the Communal Bank network consisted of 266 local offices. Since there were far too few local installations of these long-term banks, some 4,000 State Bank branches--out of a total State Bank network of 5,022 offices and branches in existence at the beginning of 1956--performed operations for the account of the special institutions. This work accounted for an impressive share of the total business of the long-term banks. Thus, 72 per cent of all long-term loans outstanding to collective farms was accounted for by balances in State Bank accounts, rather than in the Agricultural Bank, on whose behalf these advances were made. An even higher proportion--almost 90 per cent--of all individual loans extended by the long-term banks were actually handled by State Bank offices. Branches of the State Bank held 86 per cent of all investment accounts of the collective farms. Prior to 1957, State Bank offices disbursed roughly one-half of all long-term investment grants for the account of the Trade Bank.

This situation, in which the State Bank performed functions on behalf of the special long-term banks, continues at the present time. Where there are no local offices of the Investment Bank, its functions are performed by the local branch of the State Bank, either by duly authorized representatives stationed in these offices or by certain designated State Bank officials. As of July 1, 1960, for example, there were 466 Investment Bank offices and, in addition, Investment Bank representation in 444 State Bank installations. Performances of these functions is carried out in accordance with special instructions regulating relationships between the State Bank and the Investment Bank.

The 1960 State Bank statute--The adoption in October 1960 of a new statute for the State Bank of the USSR marks the first basic revision in Soviet central banking legislation since the end of 1949. The new statute was under preparation for some time; the need for some rearrangement of banking functions was recognized as early as 1957, when Khrushchev mentioned the prospect in his statement formally proposing the reorganization of management in Soviet industry in that year. This objective was achieved by the reorganization of the Soviet banking system in mid-1959; and bank reform also coincided with changing developments in agricultural finance brought about by organizational and institutional reforms in that important sector of the planned economy. The revision in 1960 of the State Bank statute thus formed part of a succession of changes, partly organizational and partly institutional, which had rendered the previous central bank statute out of date in many important respects.

The statute adopted in October 1960 deals with the status, organization, functions, and responsibilities of the Soviet central bank. It covers most of these topics in rather general language, implying that technical and operating details are dealt with in supplementary documents and instructions issued by the State Bank for use within the system. Because the older statute of 1949 is not available in published form, detailed comparisons of the changes introduced in the 1960 legislation are not possible. However, it is abundantly clear from many Soviet descriptions of the banking system that the basic principles governing the position and role of the central bank in the planned economy have not been altered in the 1960 statute, but rather reaffirmed.

The new statute thus confirms the position of the State Bank as a semi-autonomous agency of the Soviet Government whose chief function it is to supervise the financial performance of enterprises and organizations it services. It does this by exercising what is known as "control by the ruble," a continuing procedure which involves the application, when necessary, of discretionary credit granting powers, as well as of elements of what might be termed the Soviet counterpart of moral suasion. The statute also confirms the retention by the State Bank of those general functions which it possessed under the older legislation, some of which are common to central banks in the West: the State Bank possesses the note issue monopoly, regulates the currency issue, acts as custodian of the country's monetary reserves, performs fiscal agency functions on behalf of the USSR Ministry

of Finance, and organizes and manages bank clearings for the entire economy. As the source of virtually all short-term credit, the State Bank functions as a combined central and commercial banking institution organized along highly centralized lines operating under the general policy direction of the USSR Council of Ministers, implemented through the Bank's Head Office, or Administration (Pravleniya) in Moscow.

The new State Bank statute also incorporates a number of provisions of legislation adopted since the 1949 statute which it is of interest to record. The most important of these affirms the discretionary credit powers which the State Bank acquired under a decree of August 1954; this obliges the central bank, in distinguishing the quality of financial performance by debtor enterprises and other organizations which it services, to apply differential systems of credit rationing and sanctions in order to improve the performance of unsatisfactory clients. These powers supplement the State Bank's important functions in the field of short-term credit, a subject which is not to be dealt with in this paper.

There are two other innovations in the 1960 statute which, while less important, concern matters of general interest to the student of comparative central banking. Firstly, the new statute confirms the terms of legislation adopted in April 1954, which removed the State Bank from the jurisdiction of the USSR Ministry of Finance and made it responsible to the USSR Council of Ministers. This legislation, making the State Bank formally independent of and co-equal with the Ministry of Finance, restored the status it had for a number of years before World War II. The second innovation is that the earlier 25 per cent gold cover requirement against State Bank notes in circulation is not mentioned in the 1960 statute and, presumably, has been dropped.

One final point concerns provisions of the 1960 statute which have since been superseded by new regulations. The 1960 statute deals with the State Bank's duties in the field of foreign trade financing, a function traditionally handled for the State Bank by the special Bank for Foreign Trade (Vneshtorgbank), which operated virtually as a special department of the State Bank. As of January 1, 1961, all operations connected with foreign trade financing were transferred from the State Bank to the Bank for Foreign Trade. The change appears to be largely administrative in nature. The Bank for Foreign Trade, while given more operational independence in its special field of competence, apparently remains under the general policy direction of the State Bank of the USSR.

The principal significance of the 1960 State Bank statute lies in the provisions which stem from the banking reform of mid-1959 and concern, specifically, the new long-term banking functions which the State Bank acquired as a result of that measure.

Banking Reform and Administration of the Economy

Significance of banking reorganization

The banking reorganization of 1959 should be viewed as one phase of the regime's continuing efforts to improve the operation of the planned economy. By itself, the banking reorganization is important only as it is related to, and placed in perspective of, the broader organizational changes affecting key sectors of the Soviet economy.

The changes in Soviet banking introduced in 1959 may thus be interpreted as the adaptation of banking functions to the requirements posed by new systems of operation in Soviet industry and agriculture. The creation in 1957 of a network of regional economic bodies in place of the system of centralized ministries organized for the management of Soviet industrial activities along functional lines introduced a measure of decentralization of decision-making functions to regional and local authorities. However, the devolution of some decision-making powers was accompanied by a concentration at the center of those decision-making powers considered important to the pursuit of national objectives in the economic field, and by a strengthening of the centralized organs responsible for planning and for statistical, budgetary, and financial control. With the adoption late in 1958 of the ambitious Seven-Year (1959-65) economic plan, which relies so heavily on a planned increase in capital investment, it was evidently considered necessary to strengthen control over the financing operations connected with this activity so as to promote the most efficient use of resources and to prevent the frequent infractions of strict financial discipline which apparently accompanied the decentralization of some authority in the economic field. Tighter control over investment by the concentration of supervisory powers over the implementation of investment projects in the State Bank and the Investment Bank was one apparent intent of the banking reform of 1959.

Agriculture is the other area in which developments have prompted the adoption of a greater degree of supervision by the banking authorities. The 1959 reorganization provided for the concentration of all agricultural financing, both short- and long-term, in the State Bank; and although the State Bank acquired other long-term financing functions in mid-1959, its monopoly in the field of agricultural credit is perhaps the most interesting manifestation of its newer role as a mixed credit institution.

The developments in agriculture which have given rise to the need for closer financial supervision are the result of programs and policies which the present Soviet leadership has followed to redress the condition of serious and long-standing neglect of agriculture which it inherited upon Stalin's death in 1953. The succession of measures providing more remunerative prices for agricultural produce delivered or sold to the state have improved the gross revenues of many collective farms, raising their capacity to finance capital investments from their own resources, both for the maintenance of existing assets as well as for the acquisition of new means of production. In addition, the transfer of farm machinery

from State ownership to the collective farms, in connection with the reorganization in 1958 of the State-owned machine tractor stations, placed the collective farms on an entirely new footing so far as maintenance and replacement of this large stock of implements is concerned. The price increases have also improved the income status of many individual collective farm members -- undoubtedly the single most depressed element among the Soviet population -- and have also encouraged the partial substitution of cash payments for the system under which the largest share of individual peasant incomes was received in kind. All of these developments signify an increasing monetization of farm incomes, require a greater concern with proper costing and accounting practices, and multiply the occasions on which the collective farms become involved in banking and credit transactions of every sort. The concentration in the State Bank of banking operations in agriculture represents an attempt to improve the mechanism of supervision in this important field, and is the second major objective of the banking reorganization of 1959.

It seems desirable to attempt an evaluation of the organizational and functional changes brought about in Soviet banking in July 1959. The attention of Soviet planners is focussed on the attainment of ever increasing levels of real output, with the system of rewards and penalties geared to performance measured primarily in terms of physical output. Other indicators of successful plan performance, such as targets for cost reductions, savings in materials use, and the like are, generally speaking, of secondary importance. It follows that the system of financial control is largely a passive mechanism in ensuring the most efficient performance of the Soviet economy; and this explains why it is that frequent lapses from financial discipline are tacitly tolerated if planned targets for real output have been attained. Nevertheless, it may be interesting to relate the organizational changes in Soviet banking to the continuing effort which the present Soviet leaders are making to improve the efficiency of the Soviet economy, either by decentralizing some operating functions, as in industry, or by relying largely upon improved material incentives, as in agriculture.

It is of the essence of the matter that the authorities are confronted by a basic conflict in their search for greater operating efficiency. In industry, for example, efficiency may be improved by widening the area within which local initiative and the presumed better knowledge of local conditions and requirements can make a useful contribution; but this relaxation of supervision over some operating matters may -- as it has, to an astonishing degree -- lead to an excessive preoccupation with local needs at the expense of the fulfillment of projects of national (or interregional) importance. In agriculture, better monetary incentives may improve both the revenues of farming units and the incomes of individual peasants; but, especially when these have remained for very long periods at extremely depressed levels, such improved material incentives may not necessarily encourage either the pattern of agricultural activity or of investment by the collective farm, or the more dedicated effort by the individual member of the collective, which are desirable from the standpoint of the authorities. In other words, while there may be some improvement in operating efficiency, the level of attainment of established goals for industry or agriculture may not be

commensurate with the degree of operating autonomy introduced by organizational reforms or more liberal material rewards. The underfulfillment of plans may be relatively minor or it may be serious, depending upon the importance which the central authorities attach to the particular task whose achievement is jeopardized as a result of this conflict between central objectives and local initiative. There is considerable evidence which suggests, in fact, that measures and programs to improve efficiency at the local level have operated to frustrate the aims of the central authorities in some important lines of endeavor.

It is not surprising, therefore, that the authorities should feel a compelling need to reaffirm their control, not only over the over-all direction of economic development, but also with respect to specific areas of economic management, such as the planned direction of capital investment in key sectors, the allocation of important raw materials, the supply and distribution throughout the system of a basic range of industrial and consumer commodities, or organizational arrangements for the procurement and marketing of farm produce. The transfer of some decision-making functions to subsidiary political-administrative units and regional economic organs has therefore been generally limited to matters of secondary importance, and the degree of local autonomy in economic matters definitely more impressive on paper than in reality. Most commonly, devolution of operating authority has taken the form of a reduction in the quantity of detail over which the central authorities have previously exercised supervision. The counterpart of this process of administrative simplification has been the provision for stricter supervision from the center of a smaller but considerably more important range of functions in all fields, especially those relating to activities in which inter- and intraregional coordination is important. Most recently, the system of regional economic councils has been significantly modified by the creation of "super" regional economic bodies in the separate republics of the Soviet Union, designed to manage and coordinate the more numerous localized councils established in 1957. It is also an essential part of this process of further centralization that the supervisory role of Communist Party units at all levels of the economy has been heightened. In response, finally, to the development of an excess of mismanagement in economic affairs -- reflecting the reaction of local bodies in engaging in economic activities which run counter to the national interest -- the Soviet authorities have within recent months adopted harsher legislation to deal with infractions of discipline in the economic field. The recent reintroduction of the death penalty for certain economic "crimes" marks a definite reversion to the Stalin era.

The adoption of more severely punitive measures to deal with economic mismanagement tends to dramatize a general observation which may be drawn from the continuing Soviet experiment in organizational reform. In the Soviet Union, the decentralization of some economic functions should not be confused with liberalization of the economy. The Soviet experience is almost completely irrelevant to the intermittent discussion in the West of a possible transition from the strictly controlled type of planned

economy to some form of market socialism, of which the Yugoslav development in recent years provides the only important example. It is clear that there has thus far been no significant relaxation of the basic principles which have long governed the direction and management of key sectors of the Soviet economy, although one may distinguish the Khrushchev regime from its predecessor by the existence of a somewhat freer atmosphere of open discussion on economic subjects as well as by an apparent willingness to experiment with organizational and institutional modifications in the economic field. Despite a considerable amount of interesting and sometimes controversial discussion on economic topics, however, at the moment there is no evidence to suggest that serious consideration would be given to a relaxation of basic principles, such as might be involved, for example, in permitting prices to play a regulatory role in the economy.

This point may be applied to the banking field as well. The bank reforms, limited as they are, do not amount to a substitution of general monetary instruments for the system under which the chief function of Soviet financial institutions is to exercise supervision and control as its contribution to the attainment of economic goals which are, in all important respects, determined at the center of the Soviet political system. The enlargement of the State Bank's functions and the enhancement of its supervisory powers, which are the important innovations introduced in mid-1959 and confirmed in the revised statute adopted in October 1960, may improve the financial performance of producing units in the Soviet economy. However, given the emphasis on the achievement of physical output goals, and the passive nature of financial control, it is likely that the State Bank will continue to be frustrated in its attempts to eliminate entirely the infractions of financial discipline which apparently accompany the activities of Soviet managers in their struggles to fulfill ambitious targets.