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## Introduction

### *Background and Summary of the Study*

UNTIL quite recently, money and banking ranked fairly low among the features of socialist economies investigated by Western analysts, who generally tended to assign money and credit a subordinate role in achieving policy objectives in socialist countries. Many studies of the Soviet economy almost ignore money and credit and accord only tangential importance, if any, to the banking system and the monetary plans it implements. Other students of the Soviet scene, observing the impressive degree of price stability since the middle fifties, have concluded that the successful management of money must have contributed to maintaining stability and growth, and, in particular, to avoiding the surges in speculative consumer buying that have plagued some other socialist countries. In the latter view, the contribution of monetary management surely goes beyond servicing the credit needs of the economy's socialist sector and adjusting the volume of currency in circulation to the growth in disposable consumer income.

These two views are not altogether contradictory. Even official disclaimers to the effect that monetary management pursues no objectives other than implementation of the plan are compatible with the conclusion that—at least since World War II—it has played an important, if subordinate, part in an overall economic policy aimed at price stability and maximization of financial resources available to support economic growth. The Soviet authorities have been much more successful in controlling the quantity and distribution of money to prevent undesired accumulation of purchasing power than in developing a credit policy to

strengthen incentives and generally improve the performance of the economic system.

Evaluating the contribution of money and of monetary and credit planning to the overall performance of the Soviet economy is a complex problem. Trying to answer this broad question would involve assessing such aspects of economic performance as optimal investment patterns, distribution of income, social mobility, the loss resulting from inadequate use of pecuniary awards, and the stifling influence of bureaucracy, as well as the cost of various disutilities (such as pollution) associated with the growth over time of selected output and income indicators. The result of any such assessment, in terms of intertemporal or intersystem comparisons, will depend to a certain extent on the scope of the performance indicators chosen. These need not be confined to GNP, industrial production, the rate of increase in investment or personal consumption, or any combination of these. Price stability would rank high among the indicators likely to be included in any such overall assessment. The specific role of money and other financial variables in such an evaluation will depend on the significance attached to the contribution of each of these variables toward achieving the end results under review.

This monograph does not attempt to assess the contribution of the Soviet Union's financial structure and policy to the growth of its economy. My more limited objective here is to identify the role of money, credit, and financial flows in the Soviet economy and to bring out differences in techniques, as well as similarities in functions, between its monetary and financial arrangements and those in the United States and many other Western countries. Since the Soviet Union has served as a prototype for all centrally directed economies, in Eastern Europe as well as in Asia, the discussion has a broad application.

The monetary and banking system which has emerged after the credit reforms of 1930-1932 remains basic to the economic structure of the Soviet Union. The monobank-monobudget system created in the early thirties was a pioneering move by the first socialist country to provide an optimal financial structure for stimulating planned economic growth. I have referred to this system in other publications as the "standard system."<sup>1</sup> Although

<sup>1</sup>[117] and [232].

it evolved through a transition which was a part of the economic system, some of the features of the Tsarist regime. The centrally directed system is an all-encompassing system with essential features—a commercial banking system with a historical background of involvement of the state in day-to-day operations. It is considered an

Interestingly, the Soviet financial system is a vociferous non-market system with marginal influence on the economy of 1917. Their financial arrangements discuss these various banks in the socialist system after the nationalization after the October Revolution. A review of the history of Soviet financial regime and the credit reforms, including the reform of 1965.

The balance of payments standard financial structure of the unified budget system.

Chapter 3 covers the economy, beginning with the reforms and goes on to describe the planning process.

Monetary management is a part of an international

<sup>2</sup>Among the various periods, only those mentioned. Reference to which changes super

it evolved through the largely politically-determined experimentation which was characteristic of the first decade of the Soviet system, some of its distinctive features can be traced back to the Tsarist regime. There are interesting parallels between the role the centrally directed economy assigns to the "monobank"—the all-encompassing bank that is one of the present system's essential features—and the role of Tsarist Russia's State Bank and commercial banking system. Chapter 2, which considers the historical background of the present system, reviews the deep involvement of the Tsarist government with the creation and the day-to-day operations of the Russian banking system, which it considered an important tool of economic development.

Interestingly enough, some of the principles embodied in the Soviet financial and banking system were advocated by a group of vociferous non-Marxist Russian economists and publicists of marginal influence during the last decade preceding the revolution of 1917. Their proposals were of note similar to the banking arrangements that emerged in the Soviet state. Chapter 2 discusses these views and probes into Lenin's views on the role of banks in the socialist transformation of society, which resulted in the nationalization and unification of banking immediately after the October Revolution. The chapter concludes with a review of the Soviet monetary experience and the checkered history of Soviet banking between the collapse of the Tsarist regime and the establishment of the "standard system" with the credit reforms of 1930-1932 and of those features of the economic reform of 1965 which affect financial firms.

The balance of the monograph is devoted to a discussion of the standard financial system with its twin pillars—the monobank and the unified budget.<sup>2</sup>

Chapter 3 considers the role of money in a centrally planned economy, beginning with a review of Soviet monetary theory. It goes on to describe the integration of monetary control with the planning process.

Monetary management in the Soviet Union must be viewed as part of an integrated financial policy in which concern with the

<sup>2</sup>Among the various changes in credit and banking arrangements in the intervening period, only those that have broad significance or have survived up to now will be mentioned. References are provided, however, whenever possible, to original sources in which changes superseded by subsequent developments are described in greater detail.

real outcome of the economic process requires decisions of options, relating to levels and structure of prices and taxation or forced versus voluntary savings, for instance, that may involve money and credit only in an implementary way. In the context of Soviet economic policy, monetary management replaces monetary policy. Management of money is part of an overall financial strategy. It involves direct determination (referred to in the Soviet Union as "planning" and "control") rather than indirect regulation of the quantity and use of money and credit.

However, the crucial difference between the Soviet Union and nonsocialist countries is not the absence of mechanisms linking extension of credit and thus the creation of money to liquidity of banks or the use of interest rates as a means of controlling the volume and the use of credit, but, rather, the basically different role assigned to money and credit for achieving economic goals. The implementary role of credit and the derivative nature of money flows are inherent in a system in which production objectives are stipulated in physical terms, and money and credit are supplied in quantities and through channels designed to achieve output patterns and uses determined by planners. Money is needed as the universal accounting equivalent and as a medium for achieving planners' objectives with greater flexibility than direct barter would permit. At the same time, in the socialized sector, money cannot be permitted to interfere with planners' intentions. It can become effective only jointly with goods orders (vouchers) issued to implement plan objectives. Conversely, planners determine the level of cash balances appropriate for each individual enterprise and adjust these balances through loans, grants, and subsidies, as well as through transfers from or to other units.

During the last decade, Soviet monetary theoreticians have gradually recognized that writings by Marx could not serve as ready-made guides for a socialist economy, since their point of reference was a very early stage in the development of the capitalist credit and financial system. They are still far from having developed a monetary theory for a socialist society.<sup>3</sup>

<sup>3</sup>On the difference between the Soviet and the Western approach to monetary analysis, see Hodgman in Holzman [122], pp. 105-106. The following remark by Gekker is also relevant: "The paucity of data in the field of price and monetary statistics invited speculation on the why rather than on the what or the how of any numbers that now exist, and

Many of the of dissatisfaction functioned under the discussion of the modifications to

Chapter 4 is The monobank stvennyi Bank, incorporates the savings deals with virtive farms—as ment units, savings of the State Bank needs of household the Investment Reform. But ex functions other supervisory agencies only outside so reforms launch structure, although the role of the funds—reserve state.

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<sup>4</sup>Throughout this reference is made to

<sup>5</sup>The State Bank

Many of the changes introduced by the 1965 Reform<sup>4</sup> grew out of dissatisfaction with the way credit and financial processes functioned under the standard system. Chapter 3 concludes with a discussion of the developments leading to the Reform and the modifications to the credit system it introduced.

Chapter 4 is devoted to a description of the banking system. The monobank system centered on the State Bank (Gosudarstvennyi Bank, usually abbreviated as Gosbank) now also incorporates the savings bank system.<sup>5</sup> While the State Bank as such deals with virtually all parts of the economy (*kolkhozes*—collective farms—as well as state enterprises) and the various government units, savings bank offices, which have been an integral part of the State Bank for more than a decade, serve primarily the needs of households. This chapter also discusses the activities of the Investment Bank which have been much curtailed by the Reform. But even prior to the Reform this institution had few functions other than serving as the Treasury's disbursing and supervisory agent for all nonreturnable grants, which were the only outside source for financing fixed investment. So far, the reforms launched in 1965 have not materially affected banking structure, although they have increased, actually and potentially, the role of the banking system in channeling outside investment funds—reserved to the budget since the creation of the Soviet state.

The interaction of the financial system with the major sectors of the Soviet economy: governmental, state enterprise, household, agricultural, and foreign, is treated in Chapters 5, 6, and 7.

The physical as well as functional separation of enterprise money from household money is one of the basic aspects of finance in the Soviet economy. Much of the activity of the State Bank is focused on preventing spillovers from one kind of money into another. The monetization of economic relations between the state and the *kolkhozes* in the middle 1950s has generalized the use of money without significantly undermining "control by the

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which we use for measuring and judging the performance of the Soviet economy" [161]. Some of the limitations of monetary data are discussed in Appendix B. All numbers refer to the bibliography.

<sup>4</sup>Throughout this monograph, whenever the first letter of "Reform" is capitalized, reference is made to the sum total of the reform measures.

<sup>5</sup>The State Bank's internal structure is described in greater detail in Appendix A.

ruble," which is one of the basic means through which the performance of the Soviet economy is monitored.

In the Soviet Union, the choice between money and near-money is not open to enterprises and exceedingly limited for households. Liquidity is not a major consideration entering enterprise decisions. The significance of money in the accounts of socialist enterprises is fundamentally different from that of cash balances in firms in nonsocialist countries. Administrative transfers of cash balances between enterprises diminish an enterprise's interest in using them more efficiently and in releasing cash by minimizing inventories and other nonfinancial forms of working capital.

The money and credit system which took shape in the early thirties, and underwent only marginal changes in the following forty years, has proven to be a workable technical solution for an economy in which achievement of optimal resource allocation and maximum productivity are sought through administrative decisions rather than market-oriented processes. Within this system, various organizational alternatives are available. These alternatives are limited, however, because the concepts of money as an absolute carrier of options and the discretionary extension of credit are incompatible with a centrally planned and administratively directed economy. Money as an absolute claim on resources would conflict with all-encompassing planning in physical terms. In the household sector, however, with the fairly rapid increase in real incomes after the initial period of post-World War II reconstruction, money savings of households did emerge as a new factor, severing the previously rigid link between receipts and disbursements of income. Expanding domestic travel and internal migration also required more sophisticated planning of the availability of goods and services in the areas where incomes were spent but not earned. But so far neither the accumulation of household purchasing power "on the wing" nor the use of redundant enterprise balances in ways that might conflict with planners' intentions have presented serious problems.

Chapter 5 describes the institutional arrangements that assure the separation of the two money circuits and briefly touches upon the role of financial planning in adjusting the level of both flows to the requirements of a growing and changing economy. It also reviews the role of the unified budget in the centralization of

financial resources providing for outlays typical for these countries.

The credit system of 1930-1932 is described only relatively and procedurally to credit.

In the Soviet economic function, microeconomic planning enterprises and planned inventories.

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In Chapter 8 Here, the ability to aggregate equilibrium considered. While the monetary and performance capabilities of economies.

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<sup>6</sup>Thus, for instance, Moorsteen and Powell on basically identical

financial resources for economic purposes while at the same time providing for ordinary administrative and other budgetary expenditures typical for the various levels of government in nonsocialist countries.

The credit system that emerged from the reforms undertaken in 1930–1932 is dealt with in Chapter 6. Since then it has undergone only relatively small changes, mostly of a purely organizational and procedural nature and not affecting the original role assigned to credit.

In the Soviet economy, extension of credit is denied a macroeconomic function and is, in the main, related to the attainment of microeconomic goals. Credit has been mainly a means of providing enterprises with the financial resources necessary to carry planned inventories and to finance the collection gap.

Foreign financial relations of the Soviet Union are considered in Chapter 7. Although foreign trade is not among the most important aspects of the Soviet economy, recent developments in East-West trade have focused a great deal of attention on this area.

The same central direction of production that isolates the enterprise sector from the direct influence of market forces removes the domestic economy from international pressures. Export and import prices, for example, bear little relation to relative domestic prices. The difference between the ways in which trade with the West and with other socialist countries is conducted is discussed in Chapter 7, as are the international financial institutions of the COMECON.

In Chapter 8 the focus shifts to the macroeconomic aspects. Here, the ability of the Soviet monetary system to maintain aggregate equilibrium and minimize inflationary pressures is considered. While the problems are broadly similar to those confronting monetary authorities in the West, Soviet monetary policy and performance cannot be analyzed on the same basis as in market economies.

For one thing, the Soviet monetary performance cannot be subjected to the kind of quantitative macroanalysis usually applied to nonsocialist economies,<sup>6</sup> where monetary actions

<sup>6</sup>Thus, for instance, Soviet inventory data are estimated largely from bank loans (see Moorsteen and Powell [134]); therefore, correlating inventories with loans would be based on basically identical data. It is worth noting that for China, where loan data are not



affect spending units through changes in liquidity and the cost and availability of credit as well as through the consequent changes in expectations generated. In such economies, the demand for money is related to yields on near-money and other financial assets. Whether their monetary authorities pursue a passive or an active policy, its results are reflected in changes in the quantity of money and interest rates. Even when a country's policy target is the money supply (however defined), changes in the supply of money in relation to changes in the demand for it—together with the related changes in the expectations engendered—will be reflected in the level and structure of interest rates.

In the Soviet Union, because of the separation of the payment streams into two compartments and the considerable differences between the functions of money in these two circuits, the concept of total money supply has only limited analytical significance. Manipulation of the total quantity of money (as contrasted with currency in circulation) is not a policy objective. Standard Western analytical models for testing monetary aspects of economic processes are not applicable to the Soviet reality, both because of the basic differences in the role of motivation in the behavior of enterprises and the lack of the necessary data.

Furthermore, in the Soviet Union the basic problem of a rapidly growing economy—inflationary pressures—is not dealt with primarily through monetary policy. Instead, administrative controls are applied in combination with credit, budgetary, and income policies, which tends to mask the basic macroeconomic objective: to regulate monetary demand in the household sector in relation to the projected increase in the availability of consumer goods and services.

While the lack of relevant statistical data and the complications arising from the simultaneous existence of several consumer markets with different price levels preclude detailed analysis, a broad review of Soviet monetary experience is presented. The period of

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available, K. H. Hsiao [123] used the reverse procedure, estimating bank loans from inventory data. By contrast, in some socialist countries, including China, relevant data on the money supply and its composition and ownership are available for at least some limited periods. This permits some quantitative explorations, including the construction and testing of models of inflationary processes originating in wage drift, activation of household balances, excessive accumulation of inventories, or other developments not foreseen in plans.

upheaval between Soviet currency credit reforms Chapter 8 describes periods the first 1947, were changing rates. The reforms of 1930 marked for wage inflationary pressure contrast, after to nate the war-generated markets aliment *kolkhoz* farmers stores as well. lowered by virtue from a selective

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upheaval between the Revolution and the stabilization of the Soviet currency in 1924 and the following period ending with the credit reforms of 1930–1932 are discussed in Chapter 2, while Chapter 8 describes the three more recent periods. Of these five periods the first four, ending with the currency conversion of 1947, were characterized by almost continuous inflation at varying rates. The inability of the State Bank, even after the credit reforms of 1930–1932, to prevent overspending of funds earmarked for wage disbursements contributed significantly to inflationary pressures which could not be offset by other policies. In contrast, after the currency conversion of 1947 designed to eliminate the war-generated overhang of liquidity, prices declined in markets alimented by the freely disposable food surpluses of *kolkhoz* farmers and as a result of administrative cuts in state stores as well. A period of declining consumer prices was followed by virtual stability beginning with 1954, resulting in part from a selective reduction of turnover taxes.

Concluding Observations

Despite the apparent success of the Soviet financial system in keeping inflationary pressures in the postwar period within bounds and official retail price indexes stable or declining, the system's inability to allocate resources efficiently, to provide incentives to increase productivity, and to respond to developments not anticipated in plans has been recognized. The Reform of 1965 was in part due to this recognition. The modifications announced at this time were limited in scope, however, and those actually implemented, almost a decade later, still made only modest advances. Indeed, there is evidence of backtracking on some of the initial changes. Chapter 9 offers some explanations for the failure of the Reform to modify the system significantly and suggests some implications of this failure.

The example of most of the smaller socialist countries shows that there is considerable room for developing a constructive socialist monetary policy, even within the framework of a centrally directed economy, and the failure of the Soviet Union to do so no doubt accounts for the disappointing results of its economic

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reforms. In some of the countries of Eastern Europe, the basic characteristics of the Soviet monetary system—such as separation of the monetary circuits and the foreign exchange monopoly—have been retained, but negotiated credit extension has been at least partly substituted for direct administrative guidance. The emphasis in ranking has been shifted from accounting control of plan fulfillment to the evaluation of efficient use of credit by individual enterprises. In this process, banking has achieved a considerable degree of independence in developing credit standards, as well as in determining the amount of credit to be extended in each case and in negotiating and enforcing specific lending terms within the narrow range of alternatives available. Much of the microeconomic control inherent in a centrally planned economy has been shifted from ministerial bureaucracy to bank offices, even though the basic structure of a monobank is retained, and banks continue to operate within the limits of centrally determined overall credit ceilings and an interest rate structure that remains quite rigid.

In the Soviet Union, no such evolution has taken place as a result of the Reform. In contrast to reforms introduced in Hungary and, on a less ambitious scale, Poland, and attempted in Czechoslovakia—all of which followed the earlier path-breaking example of Yugoslavia—their goal has been merely to improve some operational aspects of the centrally directed economy.

The greater flexibility toward which banking has evolved in some of the socialist countries is part of their general effort to introduce at least some of the elements of the market into a centrally directed economy. They endeavor to find a workable combination of essentially indicative planning with mechanisms and processes that use the market place, its information potential, and the feedbacks generated by consumer choice (and in some instances, by producers' choice as well). The Soviet Union has persisted in rejecting the possibility of replacing administrative centralization with a socialist market. This rejection has limited the objectives and scope of the reforms introduced in 1965. It explains the retention of all those features which, since the credit reforms of 1930–1932, have made the State Bank an integral part of a complex administrative apparatus designed to implement

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Bank officials the central authority system of the market monitoring the market not diminished; of the relations began in the mid by the *zloty* in through the term the flow of accounts the measure of beam, rather than on the firing line credit, rather than bank and borrow

planners' objectives. The 1965 Reform reduced the range and details of planning indicators, introduced limited feedbacks from the market for consumer goods, placed greater emphasis on financial incentives at the microeconomic level, and restructured the costs entering into the administrative determination of prices. One of the Reform's main features involved diverting at least part of the financial flows away from nonreturnable grants, thus increasing the role of credit in capital formation. It was expected that increased and generalized use of financial incentives would increase efficiency of investment, reduce wasteful use of resources, and stimulate the labor force (above all, managerial and technical staffs) to greater effort. Other aspects of the Soviet financial system have been hardly touched by the Reform (although some marginal changes had been taking place even prior to its launching).

The reform of "economic steering," the official term designating the reforms of 1965, has put into relief the various limitations of money and credit in a centrally directed economy that retains central allocation of real resources. While it has shown that the Soviet financial system can accommodate a restructuring of financial flows, it has, at the same time, demonstrated the limitations of the role of money in a system in which administrative decisions substitute for market processes and feedbacks are minimal.

Bank officials remain administrators of policies determined by the central authorities and uniformly applied through the entire system of the monobank. The reliance on the banking system for monitoring the performance of the entire socialized economy has not diminished; if anything, it has increased with the monetization of the relationship between collective farms and the state that began in the mid-fifties. While control by the *forint* in Hungary or by the *zloty* in Poland has turned more and more into control through the terms of credit extension, in the Soviet Union it is still the flow of accounting data produced by the monobank that gives the measure of its contribution to keeping the economy on the beam, rather than the quality of decisions made by bank officials on the firing line. In fact, there is no firing line; for the issuance of credit, rather than having become a matter of negotiation between bank and borrower, retains its strictly supplementary and semiau-

omatic character. The current generation of Soviet bank officials differs from its predecessors of fifty years ago mainly in the quality of their training, not in the scope of their jobs.

The failure of overall economic performance to improve under the Reform provides no strong incentives for further experimentation along the lines laid down in 1965. At the same time, it has provided ammunition for those who have been opposing the Reform from the very beginning, and has stiffened the bureaucratic resistance to any change inherent in centralized, administratively controlled economies.

The future development of Soviet banking and credit depends on whether the Reform will remain a disappointing attempt to increase the use of financial processes and pecuniary incentives within the traditional framework of a centrally planned economy, or whether challenges to economic performance in the years to come will lead to efforts to combine central setting of overall goals with their implementation through a socialist market.

## The Origin of Soviet H

THE banking system and, more specifically, the unique in many ways institutions combining functions found in some countries, central banks implementing development financial institutions, leading industrial and commercial banks and the Soviet banks, the integration of market planning, and in the State Bank, which performance of the entire

In historical perspective, the U.S.S.R. (Gosbank) is a continuation of a relationship with its roots in Tsarist support, and state modernization, where to press