Volume Title: Money, Financial Flows, and Credit in the Soviet Union

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Volume Publisher: NBER

Volume ISBN: 0-884-10475-3

Volume URL: http://www.nber.org/books/garv77-1

Publication Date: 1977

Chapter Title: The Origins and Evolution of the Soviet Banking System: An Historical Perspective

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Chapter URL: http://www.nber.org/chapters/c4154

Chapter pages in book: (p. 13 - 35)

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The Origins and Evolution of the Soviet Banking System: An Historical Perspective

THE banking system that emerged after the October Revolution and, more specifically, after the credit reforms of 1930–1932 is unique in many respects. To be sure, examples of banking institutions combining central banking and commercial banking may be found in some nonsocialist countries. In the less developed countries, central banks have frequently assumed a leading role in implementing development programs by providing the necessary financial institutions, instruments, and markets. Even in some leading industrial countries such as France and Italy large commercial banks are owned by the government. The uniqueness of the Soviet banking system lies, rather, in the complete integration of monetary processes within the system of central planning, and in the credit and foreign exchange monopoly of the State Bank, which has broad powers of control over the performance of the entire state-owned segment of the economy.

In historical perspective, the position of the State Bank of the U.S.S.R. (Gosbank) today may be viewed as the ultimate expression of a relationship between government and banking that has its roots in Tsarist Russia. Making active use of official guidance, support, and stimulation to push the backward country toward modernization, the Tsarist government was one of the first anywhere to press banking into the service of economic progress. A brief look at the past, therefore, may be useful in throwing light on this development.

The State and Banking Prior to the Bolshevik Revolution

Several aspects of the banking arrangements after War Communism actually had close antecedents in the institutions of Tsarist Russia. Prior to 1917, government initiative frequently substituted for private initiative when it came to achieving specific objectives of economic policy and creating the financial institutions required to stimulate capital formation and economic growth.[1] Throughout the eighteenth and most of the nineteenth centuries, the state provided capital and credit (first through official banks and later through control of the privately owned banks) for significant segments of the manufacturing and mining industries, railroads, and utilities.

All of Europe's central banks, which, except for that of Sweden, were privately owned prior to World War I, made important contributions to the development of their countries' economic potential through direct lending to the private sector as well as through discount operations. In numerous cases they facilitated the financing of factories, railroads, and other facilities built in the national interest, frequently with a view to their military value. But only Tsarist Russia's State Bank, which had maintained its position as the leading source of commercial credit even after becoming the bank of issue, consistently undertook credit operations in the interest of economic development and in this connection frequently took credit risks incompatible with normal business practice. It made loans under conditions that, in some cases, were equivalent to subsidies, and occasionally waived repayment, effectively transforming loans into grants, in order to nurse through enterprises judged essential from the national standpoint. It even supplied capital indirectly to industry through loans collateralized by new securities, and provided part of the initial capital for some new banks.

The history of Russian banking is a striking example of the complete dependence of a central bank on the Ministry of

[1]For Saint-Simonist influence on several ministers of finance, see Normano [136], Ch. 1.

Finance, and of the use of the banking system (both government and privately owned) as a tool for implementing official policy. In no other country prior to World War I was the central bank so clearly a tool of government, so openly controlled by the Ministry of Finance,[2] and so heavily involved in private credit operations designed to stimulate industrial development and to serve the national interest.

The history of banking in Russia prior to the revolution of 1917 unfolds as a succession of government efforts to provide the country with a minimum of modern banking facilities—originally, to carry on trade with foreign countries; later, to support the landed gentry, the backbone of the nation's social and political structure; and ultimately, to develop a modern industry and the requisite network of railroads and other transportation and communication facilities.

The first part of Russian banking history, covering more than two centuries before the establishment of the first privately owned commercial bank in 1866, can be written in terms of the vicissitudes of not more than a dozen state-owned institutions.[3] These were operated by state officials (or former officials), pursuing objectives defined by the Ministry of Finance (or its predecessors), directed by the department of Credit Administration within the Ministry, and supervised by a high-level board whose members normally included officials of ministerial rank and, at times, close relatives of the Tsar.

Credit institutions other than commercial banks originating before the 1860's were also sponsored either by the central government (widows' and orphans' provident banks, for example, which antedated the first state commercial banks and later evolved into savings bank-type institutions), or by provincial and local

[2]In prerevolutionary Russia, the Ministry of Finance was in full charge of maintaining the external value of the ruble and the country's foreign credit. By active intervention in foreign exchange markets, it succeeded in maintaining a strong foreign exchange position for the ruble. In particular, it used part of the proceeds of its heavy foreign borrowings to build up large official holdings of gold, a significant part of which was held abroad. These holdings were used, when necessary, to buy up notes, trade bills, and other ruble claims clandestinely in order to maintain the strength of the ruble in foreign exchange markets. Tsarist Russia also engaged in secret support operations on European stock exchanges where shares of Russian corporations and Russian bonds (government, government-guaranteed, and private) were traded.

[3]For a more detailed discussion, see Garvy [233] and Gindin [32], [33] and [34]. See also Borovoy [17].

governments (noblemen's land banks and savings banks, respectively) as part of a program formulated by the central government.

From the beginning, credit from these government supported financial institutions played a crucial role in investment funding, given the scarcity of alternative sources of funds for opening mines or starting the first industries. Some of these institutions were patterned after foreign models (the discount offices, for example), while others, such as the "copper banks" designed to monetize copper (see footnote 3), grew out of conditions peculiar to the empire of the Tsars.

Since one's standing at court was frequently a more important factor in obtaining loans than either the creditworthiness of the borrowing firm or the prospective profitability of the projects to be financed, many government banks soon found their assets frozen. In some instances, existing institutions had to be liquidated, only to be replaced by others with similar purposes and sources of funds. This situation was characteristic of the period before 1861, when banking resources consisted almost exclusively of initial capital received from the State Treasury and replenished by it at various intervals in subsequent years. The fragmentary statistical data available for that period suggest that, despite administrative ingenuity in creating a variety of distinct credit institutions, the banks' total resources derived from both budgetary appropriations and deposits were relatively small.

Modern banking came to Russia at the time of the liberation of the serfs in 1861, just a few years earlier than the creation of the national banking system in the United States. The restructuring of the Russian banking system followed the financial crisis of 1857–1859 and resulted in the liquidation of practically all state credit and savings institutions. Commercial banking, which developed rapidly in the last fifty years before the 1917 revolution, was to a considerable extent subject to official tutelage, even though foreign participation in private banking capital was significant. It was highly centralized; in the last few decades preceding the revolution, fewer banks were in operation than in either the United Kingdom or Germany. On the eve of World War I, twelve institutions accounted for 79 percent of the assets of all commercial banks. P. P. Migulin, the author of one of the few existing monographs on the history of Russian banking prior to 1917, concluded that "from the very beginning in this field we had no private initiative, and the government was forced to assume it." His prescription for the reorganization of the Russian banking system included important elements of the Soviet credit system as it existed prior to the abolition of the specialized banks, as well as the creation of central agricultural, industrial, and mortgage banks under joint state-private ownership. He envisaged survival of privately and mutually owned commercial banks only if they were subject to strict government control.[4] However, official banks continued to play an important role, acting as conduits for direct and indirect government subsidies.[5]

After about 1875, the big banks which began as deposit and discount banks became mixed banks ("banques d'affaires") by engaging in securities underwriting. They held a relatively large part of their assets in equity securities, many of which were issued by government-sponsored or government-favored corporations, or by firms heavily dependent on government orders. Banks became increasingly aggressive, and for the largest among them underwriting and investment activities became very important. They provided entrepreneurship to industry, but were often misused by promoters and speculators.

Mixed banking played a considerable role in the industrial upsurge of the 1890's. The banks controlled a significant number of businesses, including many of the largest firms with the most advanced technology, and actively promoted mergers and monopolies.[6] A. Gerschenkron's thesis that, in the last decade of the nineteenth century, the mixed banking system of Russia was able to assume a leading role in the process of industrialization, is a familiar one.

A third period of Russian banking opened with the resumption of rapid growth after the depressing effects of the Russo-Japanese War were overcome. Mixed banks became a key element in the process of industrialization in their role as channelers of private capital into the new and more dynamic branches of industry and as vehicles for government subsidies and other forms of official

[4]See [62], pp. 437–439.

[5]The savings bank system was operated by the government through the State Bank. It was quite extensive (8,553 offices in 1914), but highly centralized.

[6]See Gindin [32], and Crisp, in [105].

support. Their activities in the decade preceding World War I were of a nature to support the view, widely held among Western European (particularly German) socialists, that banks had become the masters of industry. This view, as we shall see in the following section, became the basis of Lenin's characterization of the banking system as the "ready-made tool" for establishing a socialist economy and for administrating it.[7]

The state remained an important source of financing for industrial entrepreneurs through the intermediation of the State Bank, where budgetary surpluses were accumulated, while foreign loans to industrial corporations and railroads were supported by state guarantees. A foreign observer concluded that the St. Petersburg banks were "Russian in appearance, foreign with regard to their resources, and ministerial as to risk bearing."[8]

On the whole, the financial structure of Russia remained underdeveloped until the Revolution. As a result of the country's economic and social backwardness, commercial banking offices and financial institutions other than banks were concentrated in the larger cities, and financial markets and instruments were limited.

Toward the Concept of a Monobank

The idea that the banking system could make an important contribution to the economic transformation of Russia can be traced to the writings of Russian statesmen and economists, some of whom were ardent slavophiles, going back to more than a century before the revolution of 1917.[9] The first illegal Marxist group was yet to be formed when, before the turn of the century, some writers already advocated economic development via the state; a fiat currency managed by the state with the goals of domestic price stability; isolation of the ruble's international value from market forces; and a credit system that would help industrialize Russia under state guidance.

During the controversy surrounding the introduction of the gold

[7]See Garvy [232].
[8]Aghad [97], pp. 136–137.
[9]For details, see Garvy [233].

standard in 1897, views were expressed in favor of a banking and credit system very similar to the one that emerged following the Bolshevik Revolution and which assumed its present form with the credit reforms of 1930–1932. For instance, S. Sharapov, one of the leading opponents of the gold standard, advocated the use of "absolute money," completely divorced from precious metals and merely a conventional unit of account. He claimed that, in the last analysis, the domestic value of money depended on the faith of the population in the strength of its autocratic government. To support his view, Sharapov referred to long periods of Russian history when fiat money, such as leather money or paper assignats,[10] had been widely used. Sharapov held that "a country capable of an autarkic development, such as Russia, can achieve through the use of absolute money tremendous economic development, without depriving anybody of his livelihood and without risking any economic crises." He believed that the only meaningful limit to the expansion of credit was full employment, and that the only rational means of putting finance in the service of economic development was the creation of a "universal bank." Its operations in issuing credit and controlling the money supply would be governed by the needs of the economy and would not be restricted by any "prejudices" and irrelevant limitations, such as the size of the reserves of precious metals. Sharapov favored an expansion of credit and a fiduciary issue of paper money to the point where all productive resources of the society would be fully utilized.

In advocating creation of a universal bank, Sharapov anticipated the monobank. His plan provided for the merging of the State Bank into a "Great Treasury" which would absorb the network of local Treasury offices and perform all fiscal functions in close cooperation with the State Treasury, which would continue to function as an agency of the Ministry of Finance. The "Great Treasury" would, in effect, have a virtual credit monopoly.

Sharapov favored a stable domestic price level and varying the external value of domestic paper currency in relation to gold. In order to avoid business fluctuations, the State Bank should regu-

[10]Paper assignats were issued in Russia a decade before the French Revolution, although their invention is generally credited to the later event.

late the quantity of money independently of the amount of gold and foreign exchange reserves. To facilitate regulating the external value of the ruble, he logically advocated a state monopoly for all foreign exchange transactions. "The very question of [managing of exchange rates by an agency of the state] is being raised here for the first time, and it is quite impossible to say how soon the Russian state will accomplish this task." We know the answer now: it took less than a generation. Incidentally, Sharapov preferred, as Soviet planners do, using historical average prices rather than current market prices as a guide to foreign trade policy.[11]

Lenin's Views on the Role of Banking

There is no evidence to indicate that Lenin's views on the role of the banking system in the period of transition to a socialist economy, formed in the years immediately preceding the revolution of 1917, were influenced by the banking and monetary reforms advocated by Sharapov and other contemporary writers.[12] Nevertheless, Lenin envisioned a single state bank, supported by a state foreign exchange monopoly, as the "skeleton of a socialist society"[13] and the core of a socialist administrative apparatus controlling the economy.

All of the elements of Lenin's much-quoted passage on the role of banks in building socialism (see page 21) can be traced to the beginning and the middle of the nineteenth century, to Saint-Simon and Marx. But it is likely that his advocacy in 1917 of using the banking system as a tool for the socialist transformation of society was more directly related to the discussion in the pre-World War I social-democratic literature concerning the role of banks in forging powerful industrial combines and their control over industry. Lenin's specific prescription for using banks as an administrative as well as an economic tool was derived from the contemporary theories of some radical and socialist writers of

[11] [73], p. 88. For an interesting discussion of monetary theory in prerevolutionary Russia, see Vlasenko [90].
[12] For a fuller discussion, see Garvy [233].
[13] See footnote 15 below.

Western Europe, including Hobson (1902), Helphand, better known as "Parvus" (1910), and Hilferding (1910), with whose works he became familiar during his long years of exile. He used their analyses of the role of banks in advanced industrial countries, expanded by studies of more recent developments, in his book on imperialism, and made the concepts of "financial capital," "monopoly capitalism," and "economic imperialism" his own. Thus, in 1907 he wrote:

> Scattered capitalists are transformed into a single collective capitalist. When carrying the current accounts of a few capitalists, the banks, as it were, transact a purely technical and exclusively auxiliary operation. When, however, these operations grow to enormous dimensions we find that a handful of monopolists control all the operations, both commercial and industrial, of capitalist society. They can, by means of their banking connections, by running current accounts and transacting other financial operations, first *ascertain exactly* the position of the various capitalists, then *control* them, influence them by restricting or enlarging, facilitating or hindering their credits, and finally they can *entirely determine* their fate, determine their income, deprive them of capital, or, on the other hand, permit them to increase their capital rapidly and to enormous proportions, etc. [Italics in the original.][14]

Lenin advocated the creation of a single government bank as a means of assuring control over industry, but also because he believed that a nationalized banking system could be easily reshaped into the core of the socialist state's administrative apparatus. In a passage much quoted by Soviet authors, he wrote a few days before the October Revolution:

> *Without big banks, socialism would be impossible.* The big banks *are* the "state apparatus" which we *need* to bring about socialism, and which we *take ready-made* from capitalism. . . . A single State Bank, the biggest of the big, with branches in every rural district, in every factory, will constitute as much as nine-tenths of the socialist apparatus. There will be country-wide bookkeeping, country-wide accounting of the production and distribution of goods; this will be, so to speak, something in the nature of the *skeleton* of socialist society. [Italics in the original.][15]

[14]See "Imperialism," Petrograd, 1917, in [129].
[15]See [129], vol. 26, p. 106.

An identical view was expressed by Lenin after the October Revolution. "Banking policy must not stop with the nationalization of banks, but must work slowly but decisively toward the transformation of banks into a single accounting apparatus for the regulation of the organized socialist economic life of the country as a whole."[16]

Lenin's notion of the role of banks in building socialism and in directing the economy during the transitional period hardly goes beyond the theme developed by Saint-Simon, Marx, Hobson, Hilferding, and Parvus. Interestingly enough, all discussed the potential use of the commercial banking system, rather than of the central bank, in building socialism. Similarly, Lenin noted that the control which commercial banks had achieved over individual industrial firms resulted in concentration of production in large operating units. He ascribed the banks' ability to exercise this control largely to industry's dependence on them for obtaining additional equity capital as well as credit. Lenin saw their potential for central control and direction of dispersed industries in a country where regional and local units of the government's administrative apparatus were inadequate to deal with economic problems. He was impressed with the technical functions performed by the extensive branch networks dominating the scene in Germany, the United Kingdom, France, and indeed, Russia itself, rather than with the possibility of using monetary and credit policy as a tool for restructuring the economy and achieving adequate growth and stability.

As events turned out after the Bolshevik seizure of power, the monetary and banking system disintegrated under the impact of the civil war and the accompanying inflation. A state bank as envisaged by Lenin, complete with credit monopoly and complex control functions, did not materialize until almost fifteen years later, with the first Five-Year Plan well under way. When it did, the heritage from another epoch was unmistakable—an epoch when enlightened bureaucrats under an authoritarian regime had tried to use state-directed credit and Treasury resources to lift

[16][129], vol. 36, p. 220.

Lenin anticipated the development of comprehensive flow-of-funds accounts (still not developed in the Soviet Union today) when he wrote: ". . . once the banks are nationalized it will be possible to achieve a state of affairs when the government knows from where and when millions and billions of ruble payments flow." (Ibid., vol. 34, p. 163.)

Russia from centuries of economic backwardness. Sharapov would have easily recognized his "universal bank."

Soviet Banking Before the Credit Reforms of 1930–1932

On the first day of the Bolshevik coup, October 25, 1917 (old calendar), an armed detachment of workers and soldiers, under direct orders from Lenin, occupied the main office of the State Bank in Petrograd. The Bolsheviks were determined not to repeat the mistakes of the Paris Commune, which had respected the Banque de France and left its gold stock and supply of unissued notes inviolate. (At that time, the privately owned Banque de France functioned also as a bank of issue.) The Bolsheviks encountered resistance and sabotage, not only from State Bank officials but also from employees who refused to cooperate with the new officials appointed by Lenin's government.

On the day following the Bolshevik seizure of power all commercial banks closed down.[17] Their staffs received salaries for three months in advance, with the understanding that they would abstain from performing their duties as long as a Soviet government was in power, joining the concerted action of the employees of the State Bank and all other government financial institutions and ministries in refusing to serve the new regime. This boycott was fully effective. The few operations that commercial banks did undertake in the weeks following the October Revolution were directed solely toward protecting their assets while contributing to the general paralysis of economic life that, Lenin's opponents hoped, would bring down the new regime.

The new authorities were slow in making full use of the central bank. This was due partly to their lack of knowledge and experience, and partly to the fact that their immediate objective was merely to obtain currency from its vaults to meet the most

[17] On the seizure of banks and the ensuing difficulties, see Gindin [31], Atlas [6] and the articles by Azarch, Atlas, and Solovei in *D. K.*, March and August 1967. The standard source in English on the nationalization of banks and the first years of Soviet banking and fiscal policy is Arnold [100], but the detailed and illuminating account of Carr [107], vol. 1, Ch. 8, and vol. 2, sections (e) in chapters 16, 17, and 18 is superior. For a detailed account of the nationalization by the former vice president of the Central Committee of Russian Banks, see Epstein [114]. A comprehensive description of Soviet banking in the early fifties may be found in Grossman's chapter in [102].

pressing needs. Manifestly, the effective boycott by the bulk of bank employees made the use of the banking system as "the skeleton of socialist society" a practical impossibility.[18] However, during the months that followed, the total disorganization of all banking operations was gradually overcome and by the end of 1917 the cash department of the State Bank was functioning again and some discount and lending operations were taking place. In the middle of December 1917, the State Bank, as an agency of the new political power structure, was given control over commercial banks, simultaneously with the establishment of "workers' and peasants' control" over all private firms, the precise scope of which was to be determined later by agreements with individual banking institutions.

Within a few weeks, however, armed detachments led by representatives of the Bolshevik-controlled local Soviet occupied the head offices of the commercial banks in Petrograd. On December 27, 1917 (supplemented by a decree issued on January 26, 1918), the Soviet government nationalized all commercial banks without compensation of domestic or foreign stockholders by canceling all their shares. The commercial banks were merged into the State Bank, whose name was changed to People's Bank (Norodny Bank) of the Russian Socialist Republic. The nationalization of mortgage banks had preceded that of commercial banks. This earlier act was the logical consequence of the nationalization of all land, with mortgaging of land declared illegal.

The central bank of cooperatives, the Moscow Narodny Bank, was originally spared from the wholesale nationalization of banks. Organized in 1912 by the cooperative movement, which by that time had attained considerable importance, it had thousands of farm cooperatives as shareowners. For this reason, even though the bank as well as the cooperative movement were controlled by socialist parties other than the Bolsheviks, Lenin delayed nationalization for over a year, seeking a compromise. Only when the government failed to achieve control through suasion was the bank nationalized and merged with the People's Bank, the prede-

[18]Writing about this period, Z. Atlas, dean of the Soviet historians of banking and credit, commented: "However, the credit and monetary system of Russia, which was in a state of complete disorganization, could not fulfill the role of a powerful fulcrum during the time of transition from capitalism to socialism as predicted by Marx." [165], p. 11.

cessor of the State Bank. At the same time farm credit cooperatives were placed under government control.[19]

In 1918, following unification of all public budgets into a single national ("unified") budget, the People's Bank became the sole depository of government funds and was put in charge of all fiscal operations. Deposit transfers, through advice, draft, or check, became obligatory for the socialized and cooperative sectors of the economy. These two measures laid the foundations for the subsequent separation of payments circuits discussed in Chapter 5. Thus, some of the basic features of the present credit system emerged within a year of the October Revolution.

Soviet monetary and banking experience between the October Revolution and the credit reforms of 1930–1932 may be divided into the two periods 1917 to 1924 and 1924 to 1932. The first period saw the rapid disintegration of the old monetary and banking system and the subsequent long but successful struggle to introduce a stable Soviet currency. These years were characterized by unprecedented hyper-inflation fueled not only by a flood of currency issued by the Treasury but also by the chaotic state of public finances, the breakdown of the economy, the virtual cessation of foreign trade, and the fragmentation of the country as a result of the civil war. Much of the trade, particularly between farmers and the urban population, took place on a barter basis. Business transactions were typically based on valuation other than the face value of the circulating medium. Considerable quantities of goods were requisitioned by the armies and other military groups fighting in the civil war and by the related civilian authorities (or paid for in currency issued by them, or in old Tsarist rubles). At the end of the period (1924), industrial production was still less than half, and agricultural output, not much more than two-thirds, of the prewar (1913) level.

Various types of direct controls were applied to cope with the pervasive scarcities that arose with the destruction of the market mechanism during the civil war and the superinflation that deprived money of all its standard functions. During the period known as War Communism, an overall scarcity of consumer goods led to demonetization of the economy, and financial rela-

[19]See Fein [175].

tions with foreign countries ceased. The subsequent reintegration of the national territory required central direction in setting priorities and in allocating material resources under conditions of overall scarcities and a chronic shortage of foreign exchange.

Lenin's earlier view that banks should become the backbone of the socialist administration underwent a number of drastic changes not unrelated to the gradual disintegration of the economy. The focus of what consituted top priority for building socialism shifted from a centralized system of accounting and control—which the single bank could have easily provided—to the complex problem of rebuilding the Russian economy on the principles of directive planning.[20] The Supreme Council of the National Economy, the trade unions, and the soviets were successively identified as the carriers of economic transformation responsible for assuring that the decisions reached at the center of government be implemented throughout the whole country, down to the remotest corner. This reversal in policy was complete at the time of the introduction of the New Economic Policy (NEP) in 1921. By this time, a unified monetary system had ceased to exist and the country was in the grip of a wild inflation.[21]

In January of 1920—against a background of civil war, with the area controlled by the central government considerably reduced and transportation and communications almost completely disrupted—the People's (Narodny) Bank, the only banking institution still in existence, was liquidated. Its main functions were transferred to a department of the People's Commissariat (Ministry) of Finance. The economic collapse caused by the civil war was only partly responsible for the demise of the People's Bank. Equally important was the belief in the imminence of a socialist society, reflecting the influence of the extreme left both inside and outside the Communist Party. The People's Commissar of Finance, C. S. Sokolnikov, was quoted as saying that "finance should not exist in a socialist community."[22] Indeed, Marx him-

[20]In 1921, Lenin remarked: "Quite a lot was written about the State Bank at the end of 1917 but . . . it all remained largely a dead letter." [129], vol. 33, p. 91.

[21]Chachulin [21] lists 2,181 different local and regional issues of money surrogates that were circulating in the Soviet Union at one time or another.

[22]Katzenellenbaum [126], p. 98. On the intellectual origins of a moneyless command economy, see Wiles [254], particularly pp. 12 ff. "In 1928 [at the start of the first Five-Year Plan] they returned to centralized command, retaining, however, money within the command sector, in a passive accounting role" (p. 16).

self seems to have believed that a socialist society could dispense with money (little, if anything was said about credit), and that vouchers or tokens evidencing the amount of socially useful labor performed were all that the toiling population would require to obtain consumption goods. However, it soon became evident that a new economy could not be built and that the government could not function without a stable monetary unit and credit system.

A return to more conventional banking and credit practices was signaled by the creation, in October 1921, of a new State Bank of the Russian Socialist Republic, placed under the Commissariat of Finance. By the end of the year, the State Bank had begun operations in several of the main cities and its network of branches rapidly expanded in the following years.

The monetary policy that gradually emerged toward the end of this period aimed at creating a stable currency to replace the Treasury Notes (*Sovznak*—Soviet tokens). Issue of the latter increased by 11 to 15 percent per month in the first half of 1921 and by 50 to 70 percent a month in the corresponding period of 1922, the high point of the hyperinflation.[23] The monetary reform of early 1924 that resulted in the creation of a new currency system began with the introduction of the new *chervonets* currency in October 1922, with a statutory cover of 28 percent in precious metals.[24] For a time it produced a "bi-paper standard" until the old currency was completely retired. The complexities of the previous practice of linking business and some other payments to a variety of indexes and the wide use of a computed "commodity ruble" were only gradually overcome.

The gold-backed currency ultimately became the new money of the Soviet state when the currency reform was completed. While its real purchasing power declined in subsequent years, no further currency reforms were undertaken until the end of World War II.

[23]See Arnold [100], Table 19, pp. 128–129.

[24]Equivalent to 10 rubles; these were subsequently replaced by notes denominated in rubles.

The similarity of this reform with that of A. Witte which introduced the gold standard in 1897 was noted by Yurovskiy who was closely associated with the currency reform of 1924: "However great the economic upheavals through which Russia and the Soviet Union have passed since 1914, however radical the revolutionary measures which have severed the link with the past, elements of the past continue to exist in the present, and the laws passed during the recent years are in some part related to the monetary system created decades ago by Witte's reforms." [92], p. 9. See also Atlas [166].

The monetary reform of 1924 was accomplished by an effort to balance the unified budget (for the fiscal year 1924–1925); it made possible the reestablishment of a banking and credit system.

While the monetary reform terminated hyperinflation by the introduction of a "stable ruble," it did not remove the basic causes of inflationary pressures. Prices remained, however, fairly stable between 1924 and 1928, even though currency in circulation almost tripled; the improvement in the availability of consumer goods was apparently great enough to offset this increase. But between October 1, 1928 and June 1, 1932, the volume of currency in circulation almost tripled again, and consumer prices rose sharply.[25] Inflationary forces received renewed impetus from the drive toward forced industrialization, shortages in consumer goods production, and excessive issuance of credit. Rationing of food, introduced in 1928 for the urban population, was made more comprehensive in 1931; it was not abolished until 1936.

The share of private stores in total retail trade, which at the time of the monetary reform still exceeded that of State and cooperative stores combined (57.7 percent in 1923–1924), declined, but was still 5.6 percent in 1930.[26] For a variety of reasons, the official retail price index became less and less representative and, indeed, its publication was discontinued at the beginning of 1931, not to be resumed until 1956.[27]

The creation of a stable gold-backed parallel currency in 1922 permitted the organization, in the same year, of the first state commercial bank for granting long-term investment loans as well as short-term credit—the Russian Trade and Industrial Bank, known as Prombank. A new bank to service consumer cooperatives had been created already at the end of 1921 (the Pokobank) which was later (November 1922) enlarged (under the name of Vsekobank) to serve all types of cooperative organizations, including farm cooperatives.

1922 also saw the introduction of a free market for consumer

[25]R. Powell, "Recent Developments in Soviet Monetary Policy" in [122].

[26]Malafeev [57], table on p. 134.

[27]Numerous price indexes were constructed by various Western scholars, not so much because of the demonstrated defects of Soviet indexes but because few, if any, price indexes were published in the Soviet Union for a long period. After their publication was resumed, Chapman wrote: "I would not hesitate to rely more heavily on the Soviet than on my own retail price index numbers for purposes of comparing the postwar years with 1940." [108], p. 159.

goods and services under the New Economic Policy (NEP). It demonstrated that financial incentives could increase output, but also signaled potential political dangers to the regime. Related developments in the financial field involved an attempt to reintroduce a multichannel system for the extension of credit while maintaining a tight overall control by the resuscitated State Bank.

During the NEP period, L. Kamenev, at that time head of the government (Council of People's Commissars), assigned to credit the role that Lenin had hoped banks would play in the transition period. He described "centralized credit" as "this commanding high which we have created practically out of nothing" and as "the decisive factor in the regulation of the economy, the factor which [introduces decisive corrections and] is capable both of causing and preventing crises."[28]

In 1923, after the creation of the Federation following the end of the civil war, the State Bank of the Russian Republic was renamed "State Bank of the USSR" (Gosudarstvennyi Bank, abbreviated as Gosbank) and became the bank of issue. By 1925, it had retired almost all other currencies previously in circulation, including regional and prerevolutionary issues.

During this second period of Soviet monetary experience, from 1924 up to the credit reforms of 1930–1932, a system of specialized banks was created. The State Bank, however, was not able to control their credit activities, and a good deal of competition between its own lending and that of the other banks developed.

The competing commercial and special-purpose banks were created by the government in the legal form of joint-stock companies. A Bank for Foreign Trade and two banks for agriculture were also organized, and some elements of the prerevolutionary credit system were revitalized, including the savings bank system, credit unions, municipal (communal) banks, and various types of cooperative banks for agriculture, craftsmen, and small entrepreneurs. Several additional institutions to provide credit for producers' and consumers' cooperatives were created during the twenties, but all were liquidated by 1930, at the time of the farm collectivization drive. No cooperative credit organizations have survived.

Before it emerged as the single banking institution of the coun-

[28]*Planovoye Khozyaistvo*, January 1925. See also Atlas [165].

try, the State Bank had begun to perform certain bank functions vis-á-vis other banks. In particular, it was assigned the role of controlling credit policies of all other banking institutions. This control was achieved mainly through administrative means rather than the monetary policy measures employed by central banks in nonsocialist countries.

Credit planning became the main instrument of pursuing overall credit objectives. As early as 1923, the State Bank had begun to elaborate overall credit plans. The first plan to receive the formal sanction of the government covered the initial quarter of 1925. Collection of all government revenue and its disbursement were transferred to the State Bank in 1925, when the network of local offices of the Ministry of Finance was abolished, thus completing a process initated in 1918. In the same year the accounts of all local governments were also transferred to the State Bank.

The central role of the State Bank was enhanced by the issuance of new laws in the middle of 1927, which delineated the activities of various banks and assigned all short-term lending to the State Bank. Their main purpose was to delineate the type of short- and long-term credit each banking institution was to extend (so that an enterprise would not borrow from more than one bank), and to centralize resources, reporting, and control.

The Credit Reform of 1930–1932

Abolition of inter-enterprise credit in 1930 was a final step toward complete control by the planning authorities over allocation of the means of production and inventories and toward the reduction of credit to a purely implementary role. Prohibition of inter-enterprise lending left the State Bank as the only source of short-term credit, except for construction and foreign trade.

The various measures initiated in 1927 laid the groundwork for a series of sweeping changes which began with a Credit Reform (decree of January 30, 1930) and was essentially completed by a reorganization of the State Bank on the basis of a decree issued on May 25, 1932.[29] Also, in 1932, various banks engaged in long-term financing were reorganized into four such banks with well deline-

[29] For details, see Arnold [100].

ated areas of activity and deprived of the remaining responsibilities in the area of short-term credit.

These various changes and the reconstruction of the balance sheet of the State Bank in 1932 are referred to in the Soviet Union collectively as the Credit Reform of 1930–1932. Although these reforms required a significant reorganization of the banking system to be effective, the structural changes that were made subsequently dealt mainly with delineating the spheres of activity of the specialized banks, particularly those which acted as conduits for long-term investment funds. Other subsequent changes were mostly of a procedural and organizational nature. They involved, among other things, merging the specialized banks for long-term financing into a single Investment Bank in 1959 and incorporating the savings bank system into the State Bank in 1961. Otherwise, the banking structure remained unchanged, with the State Bank (Gosbank) occupying the key position, and the Investment Bank (Stroibank) and the Bank for Foreign Trade (Vneshtorgbank) fulfilling specialized, far narrower functions. Various changes in payments instruments, in the details of the deposit transfer mechanism, and in credit procedures were also made after 1932, but the main features of the Soviet banking and credit system have remained basically unchanged to the present day. This standard system has been adopted by other "people's democracies" in Eastern Europe and other areas where communist regimes have become established since the end of the Second World War.

The Economic Reform of 1965

The economic reforms initiated in September 1965 by a resolution adopted by the highest body of the Communist Party (Plenum of the Central Committee) can be characterized as a half-hearted attempt to deal with some of the most obvious shortcomings of the command economy without changing its basic character.[30]

[30]This resolution on measures to "improve the management of industry, to perfect planning, and to reinforce economic stimulation" was followed by similar resolutions of the Central Committee and the Council of Ministers on October 4, 1965.

A description of the Reform by leading Soviet economists is available in English in a variety of sources, including a series of articles which appeared beginning in 1965 in *Soviet*

They were conceived as a set of interrelated measures to improve the performance of the "economic steering mechanism" rather than as a basic revision of the Soviet system of resource allocation and the whole economic organization that implements it. From the inception of the Reform, Soviet authorities have tended to minimize the significance of the departures from the old methods. Indeed, they have constantly stressed that their purpose is to improve planning, not to work toward introducing a socialist market economy—the goal pursued in Yugoslavia and later, in a more limited way, in Hungary. Still, the 1965 Reform does represent the first change of any significance in the management of the Soviet economy since the launching of the first Five-Year Plan in 1928. It enlarged the activities of the State Bank by shifting part of long-term financing of industry to credit and by enlarging the use of credit in capital formation by kolkhozes. Otherwise, it left the structure and basic mechanism of the banking and credit system as they had evolved as a result of the changes introduced in 1930–1932.

Prior to the government's action, there had been considerable public discussion by Soviet academicians, administrators, and enterprise managers of ways to improve the operations of the economy. Proposals by Professor Liberman and other economists in the early sixties regarding the improvement of key mechanisms in the Soviet economy had produced an impressive array of arguments in favor of changes that would open, to a limited extent, the centrally directed economy to market forces.

The various steps gradually taken since the fall of 1965 were originally presented as a sweeping reform "to improve management of industry, to perfect planning, and to reinforce economic

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Life (a Soviet monthly journal published in the United States) including Birman's [218]. The collection of articles prepared for the J.E.C. [153] and proceedings of a conference held in Moscow in June 1965 (Tsagolov, [85]) contain valuable material for the period just prior to the Reform. Various aspects of the Reform are discussed in "Soviet Economic Reforms" and "A Summary Look at Reforms" in Feiwel [115]; and Borstein and Fusfeld [104]. Part 4 includes important articles on the Reform. See also Campbell [224], Grossman [237], Bratus and Ioffe, "Legal Aspects of the Economic Reform in the Soviet Union" in [113], Seidenstrecher [144], and Schroeder [250], and [251]; see also Garvy [234].

Among the voluminous Soviet literature on the significance of the reform for credit and banking, see Rumyantsev and Banich [71], Bachurin [8] and Dzhavadov [25]. For the impact on credit of reforms initiated simultaneously in other socialist countries, see Atlas [7]. References on the early Soviet articles on the Reform, same source, Ch. 6.

stimulation." Its aim was to improve the performance of the economy by reducing the range of detailed instructions from the center—without, however, giving the enterprise manager enough authority to operate the enterprise as an independent, profit-maximizing unit. To a certain extent, the Reform shifted the responsibility for short-run profit maximization from the central planner to the enterprise manager ("director"). It replaced the excessive number of plan targets to be achieved or surpassed by a mere nine success ("directive") indicators, among which total sales, profits, and the profitability ratio occupy a predominant position. The physical output of the principal product, the wage fund, payments into the budget, the value of centrally planned investments, new capacity to be added and goals for the introduction of new techniques, processes and products are the remaining planning indicators of the enterprise plan. Under the former system the gearing of all rewards to the fulfillment of goals specified mainly or exclusively in physical terms failed in providing incentives to maximize profits and to recognize adequately consumer preferences in the determination of the type of goods to be produced. Narrowing the number of success indicators made it possible for individual enterprises to concentrate their efforts on meeting or exceeding these targets in order to qualify for additional financial rewards, such as retention of a greater share of profits.

Maximization of profits is not the ultimate goal of Soviet planning. It serves, rather, as a means of achieving (or exceeding) plan targets of an individual enterprise with regard to productivity and efficient use of various inputs. The principle of profit maximization does not require, or depend upon, ownership: profit and profitability have long been central in the economic calculus in the Soviet Union, even though in economic plans they appeared as just one of many targets. The Reform introduced as additional indicators of enterprise performance a set of ratios measuring the return on (invested and working) capital and profits expressed as a percentage of total production costs, both called "profitability" (rentabel'nost'), with several accounting variants used.[31] The introduction of a capital use charge required a revision of the entire price structure.

[31]For details, see Korovushkin [49], pp. 81ff., Darkov and Maksmov [23], pp. 9 and 111ff.

The reasons for the 1965 Reform were numerous and complex, and stemmed mainly from the performance of the economy itself. For years, Western critics, as well as some Soviet economists, pointed to various shortcomings in the Soviet economy's performance, and in the early sixties there was widespread domestic concern about the key economic indicators showing less progress than during the fifties. However, there is little doubt that the immediate cause of the Reform lay, rather, in the radically changed situation in the consumer goods market. There a rising per capita real income in the early sixties faced a consumer goods output that had reached a level high enough to satisfy most basic consumer demands. After decades of chronic overall shortages, consumers began to buy discriminatingly and, in some cases, to withhold purchases, confident that more satisfactory goods would ultimately appear on store shelves. For the first time, the consumer could choose, reflect, and postpone, at least in the area of certain important periodic purchases, such as clothing and household goods.

The consumers' refusal to buy shoddy or outmoded goods was one of the immediate influences that precipitated the Reform. By postponing their purchases, they caused a piling up of goods in retail channels—while savings soared. Reports in the Soviet press amply documented this situation, succinctly summarized in an article in a leading literary monthly that made a case for greater reliance on the market mechanism.[32] To convert consumer choice into limited feedbacks, the authorities began experimenting in 1962 with a system whereby production would be guided by actual orders from retail stores rather than by planners' command. The new system made greater allowance for consumer choice without giving recognition to consumer sovereignty.

[32] "The consumer had at his disposal quite a tidy sum of money; on the other hand, an adequate supply of goods was available in retail stores. The problem consisted not in a general shortage of goods, but in a shortage of goods demanded by consumers. The consumer began to ask for a greater variety of goods; he was no longer satisfied merely to have something to put on, he wanted to purchase clothing that was beautiful and stylish. But industry continued to work on the principle 'take what you are being offered'."

Supporting figures quoted show that at the end of 1965, store inventories of cotton, wool, and silk textiles amounted to the equivalent of nearly a year's retail sales, an unusually high ratio. While discussing a similar accumulation of such diverse goods as clothing items, knit goods, sewing machines, and toys, the author points out that in the same year the increase in savings deposits almost exactly matched the rise in retail inventories of all consumer goods other than food. Petrakov [197], p. 173.

Greater emphasis on consumer choice pointed to the need for reforms via several different avenues. For example, the pressure to increase the production of consumer goods by achieving greater efficiency and flexibility in planning and better use of fixed capital investment was one of them.

Finally, maximization of benefits from foreign trade required a more rational price system for optimizing the use of domestic resources in producing for export. Removing distortions required the restructuring of domestic prices and integration of foreign trade with the domestic economy. In this area, the Soviet Reform stopped far short of the fundamental changes introduced in Hungary and the more limited reforms in Poland and Czechoslovakia, which were undertaken to make the domestic producer directly interested in the profitability of exports.

The basic characteristics of the Soviet economy were left untouched by the Reform—state ownership of the means of production, central planning of economic activity, administrative allocation of inputs other than labor, and administrative setting of prices have continued as before. In its all-important state sector, it has remained a one-seller, one-buyer economy. The planning authorities still control the relationship between enterprises and the various state organizations that supply raw materials and certain intermediate goods and direct the distribution of finished products. Contracts merely formalize these relationships and set details; monetary penalties still play a very modest role in enforcing fulfillment of obligations undertaken.