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Volume Author/Editor: George Garvy

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Chapter Author: George Garvy

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Banking and the Foreign Sector

GIVEN the marginal importance of foreign trade and the services related to it, such as transportation and insurance, and the absence of financial flows not tied to trade or tourism, the international financial relations of the Soviet Union do not rank among the most important aspects of the Soviet economy.

Foreign Exchange and the Exchange Rate

The basic difference between the role of the national currency of the USSR in relation to international payments and the role of money in countries with convertible currencies is that the ruble is strictly an internal currency.[1] When it comes to foreign trade or other international payments, it is nothing more than an internal accounting unit. The Soviet ruble is not, and never has been, traded on international exchange markets. Fluctuations in the exchange value of the ruble under the present regime of floating exchange rates do not reflect the relationship between demand

[1] Discussion in Aizenberg [1] of the role of gold in the Soviet monetary system and the relationship between the balance of payments and the money supply is typical for the treatment of these issues by Soviet writers. It ranges from the pertinent quotations from Marx and Engels to the assertion that "the strengthening of the ruble in the world arena will lead to the gradual displacement of the dollar from the position it still occupies now [in 1946] in the world market" (p. 124).

Export and import prices may be specified in a convertible currency (usually the U.S. dollar) or in rubles (usually in trade exchanges with other socialist countries). In the latter case, different implicit exchange rates apply to individual transactions which reflect a variety of subsidies and premiums, and also depend on the point of time at which the original transaction was entered into and, in some cases, the particular export (or import) organization (a ministry or its subordinated or special-purpose organization) involved.

for, and supply of, various foreign currencies, but are computed cross rates based on an administratively determined ruble-dollar rate. The administratively set exchange rates are practically permanent in the case of socialist countries. For other countries changes are made normally only to acknowledge foreign devaluations and revaluations and, since the advent of floating rates, significant changes in the exchange market.[2] Official exchange rates are neither capable of reflecting a disequilibrium in payments flows involving a trade partner nor can they be interpreted as equilibrium rates. They are, indeed, completely irrelevant for foreign trade as export prices are quoted in a convertible currency, such as the dollar. Foreign analysts and an increasing number of Soviet economists consider the isolation of export and import prices from the domestic price structure as one of the basic weaknesses of the Soviet economic system. Recognizing that feedbacks between foreign and domestic prices are essential for the optimal allocation of resources, they consider foreign trade as a leading candidate for radical reforms.[3]

The external value of the ruble rests on strict controls designed to prevent foreigners from acquiring any negotiable claims (currency, trade bills, et cetera) denominated in rubles. Nothing is revealed officially about the size or management of the gold or foreign exchange reserves of the Soviet Union. The size of its gold production has long been only a matter of guesswork, but in recent years detailed estimates have been made by Western scholars.[4]

The external parity of the ruble was set originally in terms of the U.S. dollar and subsequently (in 1961) in terms of gold

[2]Prices of goods sold domestically for convertible currency by special stores controlled by Vneshposyltorg suggest the real purchasing power of the dollar is several times the official exchange rate.

Tourist rates could not be as completely isolated from domestic prices as goods prices. Therefore, exchange rates available to tourists from socialist countries are set at levels different from those represented to be official exchange rates. In contrast to other socialist countries (East Germany being a special case), the Soviet Union does not now have special exchange rates for tourists from nonsocialist countries.

[3]Aizenberg [1], for instance, while pointing out that in socialist countries the exchange rate is independent of the balance of payments, advocates setting it at a level which would equate export and import prices with world market prices (pp. 102–104 and p. 115).

[4]For earlier estimates, see Zauberman [256] and Altman [214]. For recent estimates, see Kaser [242] and Bush [223].

(0.987412 grams).[5] Official foreign exchange parities, however, have no operational meaning, since the ruble is not convertible into the currency of any other country. Rubles that might come into the hands of foreigners, or are payable to them (for instance, royalties), cannot be exchanged for a convertible currency; only convertible currencies held by tourists and diplomats can be exchanged at the posted rates.

Two changes in the external value of the ruble in terms of the U.S. dollar were undertaken between the end of World War II and the floating of the U.S. dollar. In March 1950 the rate was raised from 5.3 to 4.0 rubles to the dollar in recognition of the decline in the Soviet price level following the currency conversion of 1947. In 1961 a new parity was established in a manner to create the impression that the external value of the new ruble had increased. Actually, however, the ruble was devalued, even though its gold content was set 10 percent above that of the dollar (and, incidentally, above that of the Tsarist ruble). Indeed, the one-for-ten rate at which domestic currency was exchanged would have required setting the value of the dollar at 40 new kopeks rather than at 90. The new exchange rate (1 ruble = $1.11) was much closer to the special rate introduced in April 1957 for "noncommercial" transactions, which applied to tourist expenditures in the USSR and foreign exchange requirements of Soviet tourists traveling to non-Communist countries and thus was more representative of purchasing power parities. While the dual exchange system was abolished at the time of the 1961 revaluation,[6] which raised the cost of foreign travel and similar expenditures in the Soviet Union by 11 percent, the overall effect of the rate unification on the Soviet balance was very small, since export and import prices continued to be divorced from the domestic price level.

The two successive changes of the U.S. dollar's parity in terms of gold, in December 1971 and February 1973, resulted in the establishment of new exchange rates based on the unchanged gold content of the ruble. In fact, since the dollar began to float in

[5]For a review of changes in the official ruble exchange rate between 1917 and 1957, see Holzman [240]. For more recent years, this information is readily available.

[6]For a review of the history of multiple exchange rates to favor tourism and for non-merchandise payments, see [1], p. 105.

March 1973, official rates have been established each month to reflect the changing value of the U.S. dollar in foreign exchange markets. For example, in September 1973, the rate offered in the Soviet Union was 72 kopeks to the dollar.

Foreign Trade and Payments

International financial relations of the Soviet Union are confined essentially to those related to trade and tourism.

Exports are equivalent to only about 4 percent of the gross national product of the Soviet Union. In part as a result of policy decisions made in the formative years of the Soviet Union, and partly as a reflection of the economic blockade following the Bolshevik seizure of power and the political isolation between World Wars I and II, the basic policy of the country has been to consider foreign trade as a means of obtaining goods which were not, or could not be produced domestically. The rich endowment of the Soviet Union in natural resources and the wide range of climatological zones within its territory made such a policy feasible.

After World War II, the emergence of socialist states on its western border, and Communist China to the south, and the creation of the COMECON offered the challenge of integrating the economies of the Soviet Union with those of its allies and planning trade to achieve common development goals. Little progress has been made so far in this direction, even after the adoption of the "Complex Program" in 1971. Nevertheless, since immediately after the war, the Soviet Union's trade with its COMECON partners has represented about two-thirds of all its foreign trade. While the exchange of goods is officially planned to achieve a better coordination of the various socialist countries' industrialization efforts, de facto, the trade partners of the Soviet Union frequently pursue policies influenced by much narrower national objectives. In more recent years, in particular since the advent of the political "detente," the closing of the technological gap with the West has become a major objective of economic policy. In recent years a number of factors have allowed the Soviet Union considerable flexibility in managing its foreign exchange obligations. These include use of the Eurodollar market, the ability of the Soviet-owned banks abroad to attract deposits from a variety of sources, and the temporary availability of foreign exchange resources of other socialist countries using these banks.

Changes in emphasis in policy objectives have not as yet eventuated in a change in the basic structure of international payments and the related mechanisms. The international monetary relations of the Soviet Union are based on direct and complete regulation of trade and all foreign payments flows. Complete control over international payments was established almost from the very beginning of the Soviet regime by introducing a government foreign exchange monopoly in 1918 and by placing all foreign trade in the hands of state foreign trade organizations. All receipts of foreign currency in whatever form are disposed of by the government through the State Bank and its agents.

The mechanics of the financing of Soviet foreign trade are quite simple.[7] In the case of imports from countries with convertible currencies, such finance has been easily handled by traditional banking channels used by nonsocialist countries and through bilateral compensating arrangements. The multilateral clearing of payments among COMECON countries has been ultimately shifted to a specialized institution.[8] The real problem has always been the attainable volume of trade and not techniques of settling international payments. The main difficulty has been the limited availability of goods which could be sold to various trade partners to earn enough convertible exchange in order to achieve import targets set in the successive Five-Year Plans. It always has been a problem of central planning, not of the financial or payments mechanism.

By the same token, the complete isolation of foreign trade from domestic production and prices[9] has deprived the Soviet Union, in every but the purely formal sense, of a link to the world market

[7] The author of the first comprehensive monograph on the foreign trade of the socialist countries, F. Pryor [141] did not find it necessary to discuss financing of this trade. Neither did many of the studies published subsequently and dealing with the foreign trade of the Soviet Union or of the socialist countries.

[8] For a short review of the history of foreign payments of the Soviet Union, see Polyakov [199] and Familton [230]. See also Altschuler [5], Meznerics [133], Wilczynski [156], Zwass [159] and Zotschew [158].

[9] On the relationship of foreign to domestic prices, see Chapter 3.

and of all the effects of continuous exposure to the shifting world pattern of demand and prices. It has also prevented the optimal allocation of resources between exports and output for domestic consumption and between alternative uses of domestic and imported materials and finished goods. It has deprived the Soviet economy of a continuing stimulus to improve product quality and technology, two areas in which improvements have been sought through administrative intervention rather than market exposure.

The foreign trade and foreign exchange monopolies, together with their close control over all nontrade transactions, permit the Soviet authorities to balance foreign obligations against expected receipts of convertible and other categories of foreign exchange. It may be said that Soviet imports from Socialist and less-developed countries basically reflect the highest level attainable given supply limitations in the Soviet Union, while those from developed countries, and in particular the U.S., reflect basic decisions of how much of a gap between the imports and exports should be financed by gold exports or foreign credit.

Financing foreign trade and managing international payments flows involve close cooperation between the Ministry of Foreign Trade (which administers the foreign trade monopoly), the Ministry of Finance, the State Bank, and the Bank for Foreign Trade.

The pattern of foreign payments is determined by four institutional factors: the state monopoly of foreign trade, the state monopoly of foreign exchange holdings and transactions, the central planning and control of the balance of payments, and the compartmentalization of foreign payments. More will be said later about each of these factors. The first three institutional arrangements had been introduced originally at the very beginning of the Soviet regime and have been copied by the other socialist countries. It is important to note, however, that these arrangements, while basically inherent in a centrally directed economy, by no means need to be maintained in the rigid form in which they have been continued in the Soviet Union practically without any significant change in over half a century. In particular, several of the smaller socialist countries now authorize some important enterprises to deal directly with foreign customers or suppliers, including those in nonsocialist countries. They also encourage exports by authorizing enterprises to retain a specified proportion of the foreign exchange proceeds of their exports to convertible currency countries. In the Soviet Union, international monetary flows are not only centrally controlled and directed, but they actually pass (with insignificant exceptions) through separate enterprises created to handle various kinds of transactions and to act as intermediaries between domestic enterprises and foreign buyers and sellers. From the point of view of an individual enterprise, there is no basic difference between domestic and foreign sales; export levels are based on targets or quotas set by planning authorities rather than the enterprise's economic decisions.

The Soviet payments system is related to planning and compartmentalization of foreign payments. The balance of payments is planned in advance each year (and projected for longer periods, such as those covered by the Five-Year Plans), country by country.[10] Trade with the COMECON countries is conducted on a cash basis multilaterally, at least in theory, and payments are planned to be compensated in full. Trade with nonsocialist countries is usually conducted on the basis of bilateral agreements, which set specific overall volume targets, with the important, but not single, exception of the U.S. While imports and exports (and invisibles) may not balance for each country, the total balance with countries with convertible currencies is settled separately. Since the ruble is not an international currency, trade between the USSR and the non-socialist countries is invoiced in dollars, sterling, or some other convertible currency, so that surpluses with one country can be used to meet deficits with some other countries.

Skillful management of foreign exchange resources on the basis of projections, formalized as foreign exchange budgets, together with a scrupulously punctual discharge of all its obligations[11]

[10]The task of projecting exchange receipts and commitments and the general strategy of managing foreign trade resources is the responsibility of the State Bank's foreign exchange planning department. It discharges this task in close cooperation with the Ministry of Foreign Trade, which has the power to restructure trade exchanges to fit the Soviet Union's foreign exchange capabilities and to make adjustments for changes in price and availability of commodities. An annual foreign exchange plan elaborated through the cooperation of the State Bank, the Gosplan, and the Ministry of Finance is formally approved by the Council of Ministers; it is, in fact, an *ex ante* balance of payments. See also Neuberger [135] and Kaser [242].

[11]The Soviet Union has never defaulted on any of its obligations to creditors in nonsocialist countries, whether they involved current transactions or credit.

enabled the Soviet Union to expand its foreign trade between the two world wars and to increase it considerably, with socialist as well as nonsocialist countries, after World War II. The world's largest gold producer outside South Africa, it has been able to meet balance of payments deficits arising from extraordinary circumstances (such as exceptionally poor harvests in 1965) by drawing on its gold reserves.

The foreign trade relations, and thus the foreign payments flows, of the Soviet Union have thus developed into three separate, though interrelated spheres: socialist countries, industrial countries with freely convertible currencies, and less developed countries. At present the difference between arrangements involving industrially more advanced and less developed countries lies mostly in the greater survival in the second group of what in fact amounts to barter agreements stipulating balancing of trade and restricting the disposal of credit balances.

SOCIALIST COUNTRIES

Formal multilateral clearing (mutual offsets) of trade and other payments was not undertaken until the formation of the International Bank for Economic Cooperation (IBEC), under the sponsorship of COMECON, which began operations at the start of 1964.[12] However, the ruble has been a unit of account for settling intra-bloc trade since 1951, and arrangements for settling bilateral balances through the State Bank have existed since 1957. As a matter of fact, even before the creation of IBEC, practically all payments between the Soviet Union and the other socialist countries (95 percent in 1960) were made through mutual offsets. Multilateral balancing, one of the main goals of COMECON, has made little progress so far. In 1973, less than 4 percent of the trade was multilaterized. This is partly due to the absence of an interrelated price system, limited coordination of national economic plans, and complexity of the annual negotiations required, and

[12]The IBEC charter, as well as the agreement underlying settlements in transferable rubles, have been published in *The American Review of Soviet and Eastern European Foreign Trade*, January–February 1966. For a description of the history of the settlement arrangement between the Soviet Union and its socialist trading partners, see Gerashchenko [29]. See also *Moscow Narodny Bank* [258], Francuz [230] and Gekker [235].

partly due to the reluctance of individual countries to incur a deficit with any trading partner.

The International Bank for Economic Cooperation. Currently, all payments between the Soviet Union and the socialist countries of Eastern Europe (except Albania and Yugoslavia), as well as Mongolia, are cleared through the multilateral clearing arrangements of IBEC. Cuba became a member effective January 1, 1974. While settlements are multilateral, the underlying trade agreements are bilateral. The intra-bloc trade is conducted, in effect, as barter trade, on the basis of binding delivery contracts and negotiated prices that are frequently completely divorced from both world and domestic prices for identical items. The trade volume is negotiated annually, at prices which apply to longer (normally, five year) periods. Trade between the Soviet Union and the participating socialist countries is conducted on the basis of agreements calling for the balancing of trade payments of each country vis-à-vis all other participating countries. These give rise to balances on IBEC's books in an accounting unit called the "transferable ruble," which is nothing more than a conventional unit of account, inconvertible into any of the currencies of the socialist countries, including the ruble. Neither are transferable ruble balances convertible into commodities, since they originate in the nondelivery of goods contracted for and no free market exists in which such rubles can be spent outside the framework of commodity trade agreed upon in advance.

Trade payments between participants are converted into transferable rubles on the basis of the official exchange rates between a member's currency and the Soviet ruble. However, non-commercial transactions (for example, those arising from tourism and various services) are converted at negotiated rates, designed to approximate more closely the purchasing power of the currencies in the consumer goods markets of the various countries. Such transactions are originally recorded in a separate set of accounts carried in national currencies. At the end of each year, balances in separate bilateral compensating accounts for service payments are reduced by a conversion factor originally set at 3.4 in 1963 and in 1971 reduced to 2.3 and added to balances arising from merchandise trade.[13] Thus, net credit or debit balances that may

[13]For further details, see Zwass [159]; see also Babitchev, in [118]. For a history of

result in a given year from the failure of one or both parties to achieve the volume of trade originally agreed upon can be offset (or further aggravated) by service and other nontrade payments, including those arising from joint investment projects. A debtor country may receive credit from IBEC within stipulated limits (in fact, automatically up to 6 percent of the total amount of the trade volume), which can be repaid only by delivery of additional goods acceptable to the other party. Such repayment may be reflected in appropriate adjustments in the following year's trade agreement. A limited volume of credit with fixed maturities of up to five years (with interest rates ranging up to 5 percent) is also available.

In 1973, IBEC's tenth year of operation, clearings exceeded 47 billion rubles and mutual offsets between members were still its main activity. Temporary imbalances between receipts and payments of individual countries required in 1973 extension of 3.8 billion of short-term credits in transferable rubles, or about 8 percent of the payments compensated (95 percent of which were related to trade). These loans carry a nominal interest rate charge which, since 1970, has ranged, depending on maturity, between 2 and 5 percent per annum, with the highest rate charged on loans overdue.[14] Temporarily redundant funds in convertible currencies deposited by IBEC members are invested mainly in Eurocurrency markets (or are re-lent to members).

The balance sheet of IBEC is small compared with its operations. At the end of 1973, total assets of the institution, through which trade and other payments of the socialist countries of Europe are settled, were still less than 2.8 billion transferable rubles (with loans extended accounting for nearly 60 percent of the total, and funds held on deposits for most of the remainder), not much more than the assets of the smallest among the Federal Reserve Banks.

NONSOCIALIST COUNTRIES

Trade relations of the Soviet Union with nonsocialist countries have been expanding rapidly in recent years, particularly with the

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multiple exchange rates covering non-trade transactions among socialist countries, see Aizenberg [1].

[14]In practice, a large part of credits extended is interest-free. Statutory charges ranged originally for 1½ percent for seasonal credits to 3 percent for amounts past due.

highly industrialized Western countries. In the years immediately following World War II, such trade was conducted on the basis of agreements providing for bilateral balancing, with all payments cleared through an account maintained at one of the central banks. Trade with advanced countries, many of which have in recent years provided a considerable volume of export credits, has gradually become subject to a more flexible payments regime, generally involving payment in convertible currencies of balances in either direction at the end of the year, or else settlement of all payments as they become due in a specified convertible currency. In the sixties, "switch trading" was developed for the purpose of disposing, at a discount, excessive credit balances in bilateral accounts by triangular and other complex transactions. Such trading has shrunk considerably since the late sixties, but has rebounded with the oil crisis.[15]

Foreign trade with most less developed nonsocialist countries (currently about seventy) is still ruled by trade treaties that stipulate the volume and commodity composition of mutual trade, as well as the mode of payment and other details of settlement. In recent years, there has been a growing tendency on the part of the Soviet Union to replace such agreements with treaties stipulating merely the target levels of trade exchanges, with all balances to be settled in convertible currencies.

Typically, trade agreements cover several years and are supplemented with annual "protocols." The underlying negotiations are carried out on the Soviet side primarily by the Ministry of Foreign Trade, which also normally negotiates any extension of foreign credits that might be involved.

Annual plans for international payments (foreign exchange budgets) are prepared by the Soviet Union for each country with which it trades. Such plans are aggregated by currency area, and are ultimately incorporated in overall plans for all convertible currencies and those cleared through bilateral accounts. Obviously, planning of payments involving nonsocialist countries must take into consideration possible price fluctuations and cyclical and other influences relevant to the ability of the Soviet Union to buy and sell in those markets.

[15]See "Back to Barter," *The Economist*, Sec. 14–20, 1974.

Advance planning of trade with each country generally aims at balancing payments flows in each direction (allowing for invisibles), taking into account any available sources for financing imports. Last resort use of monetary gold is reserved for meeting deficits with countries whose imports are essential for implementing Soviet longer-term plans for enlarging capacity and upgrading technology.

While Soviet planning involves advance decisions with regard to each country, a meaningful overall picture is obtained by observing the trade gap with all countries with which Soviet trade is conducted in convertible or "hard" currencies, estimates of invisible payments, and the two sources of financing—loans and gold sales. The overwhelming bulk of trade in hard currency (estimated at 90 percent in 1971) is with developed countries. These estimates may involve significant percentage errors for several minor items. All items other than merchandise trade are estimated on the basis of various types of evidence and assumptions, since the Soviet Union does not publish balance of payments statistics (see Table 7.1).

One estimate of the share of gold sales in settling deficits with convertible currency countries and the level of USSR gold reserves is given in Table 7.2.

Since data on gold production, sales or monetary stock are not released by the Soviet authorities, and private estimates have been frequently revised in the past and do not agree among themselves, the data in Table 7.2 should be considered essentially as indicative of the order of magnitudes involved rather than as a close approximation of year-to-year changes in the various series shown.

Private estimates of Soviet gold production and its use, which differ considerably from data widely used earlier and based on Central Intelligence Agency (CIA) estimates, are given in Table 7.3, measured in metric tons.

As can be seen from Table 7.2, settlement of the convertible currency deficit required gold sales, but estimated sales do not match deficits year by year. In 1960, about one-third of the deficit could be met from net receipts from medium- and long-term loans. Gradually, repayments rose more rapidly than new loans, so that by 1965 loan financing (net) had shrunk considerably.

TABLE 7.1

Estimated USSR Hard Currency Balance of Payments
(billions of U.S. dollars)

	1960		1965		1970		1971		1972[a]	
	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit
Goods and services		292		211		496		274		706
Merchandise f.o.b.	768	1018	1374	1563	2197	2711	2652	2955	2900	3500
Transportation, net		65		45	35		50		[b]	
Travel	25	[b]	46	9	81	19	96	21	[b]	[b]
Interest payments		2		17		79		96		106
Payments to U.N.		15		27		40		43		45
Lend-lease repayments		11		11		11		11		12
Medium- and long-term credits	125	37	190	149	700	319	700	387	900	457
Gold	200		550			[c]	[c]		250	
									300	
Errors and omissions (net)[d]	30			342	166		15		20	

SOURCE: [154], p. 703.
[a] Preliminary.
[b] Not available.
[c] Negligible.
[d] Includes changes in hard currency holdings and short-term capital movements.

TABLE 7.2

Financing of the Convertible Currency Deficit by Gold Sales (millions of dollars)

Year	Convertible Currency Payments Deficit (positive)	Gold Sales	Gold Reserves[a]
1960	250	200	2555
1961	161	300	2365
1962	233	215	2550
1963	275	550	1800
1964	483	450	1495
1965	186	550	1095
1966	238	[b]	1265
1967	95[c]	15	1425
1968	109	12	1590
1969	311	[b]	1765
1970	514	[b]	1945
1971	303	[b]	2135
1972	1100	250–300	2400

SOURCE: [154], p. 702.

[a] Gold sales 1960–1968 and reserves (at year end) are calculated at the official price of $35 per ounce and $38 for 1972.

[b] Negligible.

[c] Surplus.

Foreign Credit and Investments

The Soviet financial system does not permit financial investment or even holding of balances in foreign exchange by foreigners other than diplomats. International flows resulting from lending not directly related to foreign trade and investing are insignificant. Until the end of World War II, Soviet international credit flows, like those of Tsarist Russia, were one-sided. The Soviet Union was a borrower, mainly on short-term capital accounts.[16] It continues to finance a large part of its capital imports through

[16]The Soviet government did not have to meet problems arising from foreign holdings of Russian securities, since all such claims (whether denominated in rubles or in foreign currencies) were repudiated after the revolution. No funded borrowing abroad (in contrast to using bank and vendor credit) was ever attempted by the Soviet government.

TABLE 7.3

Soviet Gold Production and Reserves
(in tons)

	Output	Sales to West	Other Uses	Change in Reserves	Year-End Reserves
1940	140				
1950	139	—	5	+123	1446
1951	141	—	5	+135	1581
1952	143	—	6	+143	1724
1953	144	67	6	+ 77	1801
1954	145	67	7	+ 74	1875
1955	146	67	8	+ 70	1945
1956	147	133	10	+ 8	1953
1957	153	231	11	− 85	1863
1958	162	196	12	− 42	1826
1959	173	222	14	− 61	1765
1960	181	178	15	− 5	1760
1961	197	173	16	+ 12	1772
1962	210	191	19	+ 5	1777
1963	222	489	20	−280	1497
1964	237	401	21	+178	1319
1965	254	488	23	−251	1068
1966	268	—	25	+253	1321
1967	283	13	28	+208	1529
1968	299	10	31	+263	1792
1969	325	—	33	+285	2077
1970	347	—	37	+299	2376
1971	360	20	42	+283	2659
1972	379	190	57	+113	2772
1973	398	280	86	+ 5	2777
1975 Plan	441	..	..	..	..

SOURCE: Michael Kaser, "Comecon," *International Currency Review*, May–June 1974, pp. 60–62. For output only, revised in 1975 (private communications from Mr. Kaser). The revisions are small (not exceeding 10 tons) prior to 1965; they are higher for 1969 and the following year.

"barter-on-time" in which imported equipment is paid for in kind by the additional output which it produces.

In fact, in some respects 1965 represents a turning point in the financing pattern of the trade deficit in convertible currencies. Following relatively large gold sales to help finance imports of grain following poor harvests in 1963 and 1965, gold sales could be reduced considerably as alternative credit sources became availa-

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ble. As a result, and following the more intensive working of old, and the discovery of new, gold fields, the Soviet gold stock, which by the end of 1965 had declined to little more than $1 billion (or by nearly 40 percent in five years), is estimated to have risen by the end of 1972 (measured in tons) rapidly. According to Kaser (Table 7.3) it was at a level considerably in excess of the end of 1960 volume. Since the mid 1960s, greater reliance on (and availability of) foreign loans has rapidly raised the ratio of debt service to convertible currency exports from 5 percent in 1960 to 18 percent ten years later, and 19 percent in 1972, as medium- and long-term debt in convertible currencies is estimated to have risen by the end of 1972 to $3 billion. The Soviet Union, and its creditors, might consider a 20–25 percent debt service ratio as an upper limit.

Foreign credit available to the Soviet Union (apart from the short-term credit normally extended for various raw materials and nondurable goods) falls into three main categories: vendor credit, bank credit, and official loans. These distinctions are less than clearcut in the case of some of the main exporters of machinery and equipment (such as France and Italy) where the principal commercial banks are nationalized, or where some export credits are granted by government-owned corporations. In any case practically all loans are issued by government-sponsored organizations. In contrast to the other socialist countries, the Soviet Union had not as yet attempted until late in 1974 to borrow long-term in international capital markets, such as the Eurodollar market, although Soviet-owned banks have participated in consortia sponsoring such borrowing by banks of several of the smaller socialist countries.

The Johnson Act precludes such borrowing from the U.S. since the Soviet Union has refused to recognize official debts of Tsarist Russia. This contrasts with the ease of almost all of the other countries of Eastern Europe which have reached agreements with the U.S. and other creditors to settle debts of their respective governments made prior to the institution of Communist regimes.

Since the advent of the detente the Soviet Union has endeavored to obtain U.S. and other foreign financing for a variety of large projects, involving mainly natural resources. Such arrangements have been, in fact, barter deals with an extended horizon;

repayment for foreign machinery, equipment, engineering service, and knowhow is to take place over long periods (stretching out as long as the lifetime of a generation) through the delivery of products of these projects. Represented as "self-liquidating credits," these arrangements (few of which have been consummated as yet) are congenial with the Soviet emphasis on the real, as contrasted with financial, aspects of economic processes, since they do not make the interest cost as explicit as in financial borrowing. The acceptability of such projects to private entrepreneurs depends not only on such political factors as assessment of the status of such arrangements under a different Soviet leadership, but also on the anticipated time profile of world market prices for the products to be received in repayment over an extended period and the nature of adjustment formulas and mechanisms built into such contracts. It appears that the various sources of finance for Soviet import surpluses from Western countries discussed have been, or are about to be, exhausted before Soviet trade has expanded to a volume generally considered desirable and feasible. This raises a number of broad questions with regard to Soviet economic policy which are, indeed, beyond the scope of this study.

After World War II the Soviet Union began to grant credit to other socialist countries and to some underdeveloped countries, normally in connection with the export of capital goods. In some exceptional cases it made hard currency loans to countries in Eastern Europe confronted with pressing reconstruction needs or with political difficulties. Export of capital to underdeveloped countries is accomplished largely through supplying goods (including complete factories) and services, partly on a grant-in-aid basis, partly against future deliveries in kind.[17] In fact, with very few exceptions, international borrowing and lending involves product payback schemes, which involve barter on time, the contracts merely being the recording of the monetary value of goods deliveries related to negotiated investment projects. This applies also to investments in socialist countries through the International Investment Bank (IIB) since its creation in 1971 (see

[17]For a detailed historical review of foreign lending to the USSR since 1917 and of credit extended by the USSR to the developing areas and to other socialist countries, see Komissarov and Popov [46], Ch. 18.

below) and prior to that, to the bilateral and infrequent multilateral investment projects.

Shares of the member countries in the Bank's capital of 1,052.6 million transferable rubles (in small part to be contributed in convertible currencies) are related to the relative importance of each in inter-COMECON trade. During the first three years of operations the IIB made commitments to finance 33 projects with loans aggregating 280 million rubles, about half of which was in convertible currencies. Following the example of the International Bank for Reconstruction and Development, the IIB established in 1973 a special fund designated to extend long-term credit to less-developed countries. The first IIB loan to the Soviet Union was granted at the end of 1973, although in the preceding years some socialist countries had participated in large-scale projects in the Soviet Union by supplying equipment and thus establishing "loans" repayable in goods to be produced by the individual projects.

The Soviet Union has not joined any of the international monetary and financial organizations although its delegates attended the Bretton Woods conference in 1944 at which the IMF and the IBRD were established. Despite various statements by Soviet officials in recent years that the Soviet Union might reconsider its position, acquiring membership in the two organizations and, in particular, in the IMF, would involve reporting obligations requiring disclosure of data which so far the Soviet Union has been unwilling to make public. The 1951 breakdown of the monetary arrangements administered by the IMF and the subsequent failure to make significant progress toward establishing a modified or alternative regime have been additional factors in diminishing the pressure on the Soviet Union to reconsider its original position.

Neither has the Soviet Union joined the Bank for International Settlements (BIS), of which all the other European members of the COMECON are members, continuing an association which goes back to the founding of the Bank in the early thirties. In this case, the ownership of shares in the BIS which were acquired by the Baltic states at the time of the Bank's founding, and the status of gold held in their accounts, constitute legal hurdles which need to be, but have not been, resolved to clear the way for membership.

The Bank for Foreign Trade

Although the Bank for Foreign Trade (Vneshtorgbank) was organized in 1922, until 1961 it operated virtually as a department of the State Bank.[18] Its responsibilities were limited to handling foreign exchange operations of a non-commercial character, such as dealings with foreign diplomatic missions, and foreign remittances. All other foreign banking activities were normally carried out by the State Bank.[19] In 1961 the Bank for Foreign Trade was reorganized and given greatly expanded operating responsibilities for the financing of Soviet foreign trade, while remaining subordinated to the State Bank in all policy matters. In fact, the Bank for Foreign Trade is now the point of contact of foreigners for all financial transactions with the Soviet Union.

Foreign operations are conducted by the Bank for Foreign Trade under the direction of the State Bank, which has been in charge of administering the foreign exchange monopoly since 1922. At the beginning of 1964, all correspondent accounts of the State Bank with foreign commercial banks were transferred to the Bank for Foreign Trade, with the State Bank retaining only accounts with foreign central banks. All dealings in the Soviet Union with foreign tourists and other foreigners remain in the hands of the State Bank, due to the very limited facilities of the Bank for Foreign Trade, which operates branches only in Leningrad (since 1968) and in the new Pacific port of Nachodka (since 1970).

The Bank for Foreign Trade now operates very much like the

[18]For the statutes of the Bank, see *D.K.*, January 1963. See also Gekker [235].

[19]The State Bank maintains currency exchange facilities at border crossing points, airports and railroad stations and in hotels in which foreign tourists are lodged (those operated by "Inturist," the organization in charge of foreign tourism). The State Bank also provides limited and strictly regulated facilities for nationals and foreigners who maintain accounts in foreign currencies, which can be used abroad or converted into rubles. The State Bank also provides foreign exchange to Soviet citizens travelling abroad.

The State Bank will automatically buy currency of, or checks on banks of, a non-communist country (although those denominated in nonconvertible currencies are accepted only "on consignment"), but it will not freely exchange bank notes of any socialist country. As a rule, funds for travel in socialist countries are carried in travelers' checks denominated in the currency of the country a Soviet tourist plans to visit.

foreign department of any of the roughly 1,500 foreign commercial banks in about one hundred countries with which it maintains correspondent relationships. In order to facilitate business relations with foreign commercial banks, the Bank for Foreign Trade is organized along the lines of a European joint stock bank; the State Bank holds the bulk of its shares while the Ministry of Foreign Trade and some other official organizations hold the remainder.[20]

The Bank's domestic activities include paying (in rubles) domestic foreign trade organizations the proceeds of exports and any service and other foreign payments due them. It extends credit to various state enterprises in charge of foreign trade. In effect, however, in providing short-term ruble credits, it merely acts as an agent of the State Bank. Table 7.4 presents its balance sheet for the end of 1973.

The Bank for Foreign Trade's activities in connection with export and import financing are conducted in close cooperation with several Soviet-owned banks abroad. In addition to the usual activities of banks specializing in foreign trade (such as collections), these banks raise funds for bridging temporary gaps in the availability of convertible currencies, transfer, and convert funds, take foreign exchange positions, and invest temporarily redundant foreign exchange. They maintain wide networks of correspondent banks to service their own needs as well as those of the Bank for Foreign Trade and the State Bank, and of official banks of other socialist countries using their services.

Soviet-owned banks abroad give the Soviet Union (and other socialist countries) a point of contact with the money markets of the West for dealing in gold and convertible currencies and for participation in the Eurodollar market. Indeed, these banks were major participants in the Eurodollar market at its inception. Two

[20]In contrast to the State Bank, the Bank for Foreign Trade operates in a competitive environment and its operations abroad must conform to foreign usage. Its operations must adjust continuously to fluctuations in foreign exchange markets, and numerous other changes in conditions over which it has no control. In contrast to the personnel of the State Bank, the staff of the Bank for Foreign Trade must continuously assess markets and trends and make quick decisions to take advantage of opportunities as well as to protect the Bank's interests and to avoid losses. The senior personnel of the Bank for Foreign Trade is given additional training in foreign banking through tours of duty with the Soviet banks abroad.

TABLE 7.4

Balance Sheet of the Bank for Foreign Trade of the USSR as of January 1, 1974
(in millions of rubles)

Assets		Liabilities	
Cash and bank deposits	2,070	Deposits	8,289
Investments	15	Borrowing, guarantees and acceptances	4,278
Loans and discounts	11,172	Capital	594
Other assets	2	Profits and reserves	94
		Other liabilities	4
Total	13,260	Total	13,260

SOURCE: *D.K.*, August 1974.
NOTE: Loans are gross and include acceptances and guarantees offset by a counterentry under liabilities. The various foreign assets and liabilities are presumably converted into rubles at official exchange rates.

of these banks occupy an important position in the cities where they are located: the Moscow Narodny Bank in London and the Banque Commerciale pour l'Europe du Nord in Paris.[21] The Moscow Narodny Bank was originally established in London before World War I as an agency of a Russian Bank for Cooperatives. The Banque Commerciale pour l'Europe du Nord was bought by Soviet interests in 1925 from Russian anti-communist emigrés who organized it. The shares of both banks are owned entirely by various official entities of the Soviet Union. They have been able to attract a large volume of deposits from a variety of sources, including firms doing business with the Soviet Union and other socialist countries, and correspondent banks of the official banks of these countries. Both banks are very active in all kinds of transactions related to the foreign trade of the socialist countries of Europe, as well as of Cuba and China.

While the activities of the Paris bank began to expand rapidly in the early fifties, the growth of the Moscow Narodny Bank in

[21] Other Soviet-owned banks abroad are the Voskhod Bank, organized in 1966, in Zurich, the Ost-West Handelsbank formed in 1972 in Frankfurt, and the Russo-Iranian Bank in Teheran, carried over from the pre-revolutionary days. The Moscow Narodny Bank, which, in the twenties, had branches in New York, Paris, and Berlin, opened a branch in Beirut in 1963. Between the two World Wars, additional foreign banks owned by official Soviet interests operated in several other countries of Europe and Asia.

London after the advent of convertibility of most Western currencies in 1958 may be termed extraordinary. In addition to credit operations related one way or another to East-West trade, it conducts a variety of other operations, including some designed to acquire and maintain the image of a British bank, with the usual commitment to discount operations. By contrast, the Paris bank specializes in foreign exchange operations and various types of financial intermediation.[22] The Moscow Narodny Bank, together with the other officially owned Soviet banks abroad, not only facilitates the trade of the Soviet Union (and the other socialist countries) with the nonsocialist countries, but also serves as the channel for the sale of gold and for managing the foreign reserves of the Soviet Union.

[22]See Gekker [235].