

Wilczynski, J.

Article — Digitized Version

## Money and banking under the new system

Intereconomics

*Suggested Citation:* Wilczynski, J. (1970) : Money and banking under the new system, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 05, Iss. 5, pp. 154-157,  
<https://doi.org/10.1007/BF02928735>

This Version is available at:

<https://hdl.handle.net/10419/138343>

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however, less a result of consciously pursued policy than the maturing of non-interest bearing treasury bonds of the Federal Government of which about DM 4,600 mn were paid back in 1969.

### Conclusions

This fairly long term review of those factors which govern the economy as a whole does not give rise, as yet, to any hopes of a speedy, lasting and fundamental easing of the position on the German money market in the near future. Speculation on exchange rates has come to an end and an influx of currency from this source is, therefore, very improbable. One must, on the contrary, reckon with further effluxes even if they are on a smaller scale if German enterprises have to repay foreign credits borrowed when

currency was in full flood. Differences in interest rates between the German, the foreign and Euro-markets have, it is true, been reduced but as long as the policy of contraction continues—and this particularly applies to the USA—we need not reckon with pressure on the German interest levels emanating from pressure exerted through international interest developments. Conversely, one cannot force down the whole interest level by a one-sided domestic policy of interest reduction. The restrictive financial policy with its tendency to create surpluses on Federal Bank Accounts will make its own contribution to keeping bank liquidity short and, in that way, to keeping the money market tight.

Taken all in all: dealers on the German money market will have to reckon with high rates for daily money during the coming months.

## Money and Banking under the New System

by Dr J. Wilczynski, Canberra \*

**M**onetary policy under central planning of the Socialist type is much more intimately integrated than under Capitalism with wage and fiscal policies, and these are further reinforced by direct controls where necessary. The overall objective of the monetary policy is to provide a financial basis conducive to plan fulfilment and monetary equilibrium in the economy. Before the recent reforms, the scope for monetary policy was pretty limited, as money performed a passive function.

Under the new system, basic proportions in the economy are still centrally determined, but otherwise enterprises have a good deal of freedom in deciding on the details and methods of fulfilling the plan. Directives and prohibitions have been largely replaced with financial incentives and disincentives administered flexibly by monetary authorities. The new system is accentuating inflationary pressure, which provides a new challenge to monetary policy.

### Monetary Policy

One of the principles adopted in the reforms is the rule of self-financing. This means that enterprises, even in the sphere of investment, have

to rely basically on their own resources instead of central allocations from the State budget. This has produced a change in payment flows in the economy. Grants to enterprises are now smaller, and so are their payments to the State budget. Instead, deliveries are now financed mostly "horizontally" on the enterprises' own initiative. In this process, banks have assumed an active role.

The increasing importance being attached to monetary policy is indicated by the growing number of publications on the role of money, credit and banks. In these discussions Western achievements in the sphere of monetary theory and policy are also analysed with a view to possible adaptations to modern Socialist economic conditions. Two British economists, T. Wilson and G. R. Denton, who made a thorough on-the-spot study of the Yugoslav economy in 1967 concluded that "Yugoslavia is relying more upon banking policy than is Britain". Meditating on the modern trends in Socialist countries, a Polish monetary expert Z. Grabowski concluded: "... who knows, if in the light of these developments the theoretical assumption of the withering away of money with the transition to Full Com-

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\* Senior Lecturer in Economics at the Royal Military College of the University of New South Wales, Canberra.

munism is still tenable. Perhaps not all paths leading to Communism must deviate from money".

### The Banking System

The banking system in each Socialist country is, of course, socialized, highly centralized and operating on a branch (as distinct from an independent unit) basis. Banks collect the means of payment from the State and the public, organize cash and non-cash payments on a planned basis and supervise the use of finance by enterprises and institutions.

The recent economic reforms have affected the Socialist banking system in three major respects:

☐ Increased Role of the Banks: Socialist banks are no longer mere administrative agencies of the Ministry of Finance carrying out detailed instructions. They can now take some of the initiative in promoting developments of social importance on a sound economic basis. The system is now noted for greater flexibility and adaptability.

☐ A Greater Functional Specialization: In most Socialist countries new banks have been established in recent years to service the specialized needs of industry, agriculture, foreign trade, etc. The former institutional division between short and long-term financing has been largely removed and each bank now extends both types of credit. The banks are well equipped with a network of specialized technical, engineering, agricultural and commercial teams to assist them in acting as financial advisers and in controlling the application of funds.

☐ A Greater Financial Centralization: A stricter control of financial processes from above has proved essential as a consequence of a greater independence of enterprises, and the fact that finance has become a more influential factor at the operational level. This development is interpreted as an expression of the Leninist principle of "democratic centralism". On the one hand, banks have been given greater powers over enterprises. On the other, the activities of the banks at the operational level are now subject to stricter supervision and control by the inter-

mediate agencies of economic administration (branch associations, regional authorities) and by the central bank.

### Co-ordination of Activities

The overall banking policy in each Socialist country is laid down by the Ministry of Finance in close co-operation with the State Planning Commission and the State Bank. The latter is the central bank and it performs similar functions to those in a Capitalist country—note issue, carrying out the Government's financial policy, refinancing other banks, supervising (or directly administering) foreign payments, and in addition servicing the State budget. It also prescribes the rules governing bank deposits, the extension of credit, interest rates and bank accounting and statistics. In most of these countries it is responsible to the Ministry of Finance, but in Bulgaria and the German Democratic Republic (GDR) it answers directly to the Council of Ministers.

In addition to the State Bank, in each country there is usually an investment (or industry) bank, an agricultural, a savings and a foreign trade bank. Some of them also have a bank of commerce, a maritime bank and a number of co-operative banks. The latter are owned collectively, their function being to cater for the needs of handicrafts, small farms and shops. They are best developed in the GDR and Yugoslavia.

The structure of the banking system in each European Socialist country is represented in the Table below. Where there are no specialized

The Structure of the Socialist Banking System

Country	Central (State) Bank	Industry (Investment) Bank	Agricultural Bank	Co-operative Bank(s)	Savings Bank	Bank of Foreign Trade	Other Bank(s)
Albania	×	—	—	—	—	—	—
Bulgaria	×	×	×	—	×	×	×
Czechoslovakia	×	—	—	—	×	×	×
German D.R.	×	×	×	×	×	×	×
Hungary	×	×	—	—	×	×	×
Poland	×	×	×	×	×	×	×
Rumania	×	×	×	—	×	×	—
USSR	×	×	—	—	×	×	—
Yugoslavia	×	×	×	×	×	×	×

## VEREINSBANK IN HAMBURG

*Established 1856*

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58 BRANCHES AND AGENCIES IN HAMBURG, CUXHAVEN AND KIEL

banks, the banking services concerned are provided by the State Bank. The extreme case is represented by Albania which has only one bank with specialized departments. All European Socialist countries, except Albania and Yugoslavia (but including Mongolia), belong to the International Bank for Economic Co-operation. It has its head office in Moscow, it started operations in 1964, and its function is to facilitate payment settlements among member countries.

The role of the banking system in a Socialist economy differs in two important respects from that in a developed Capitalist country. On the one hand, banks—not being privately owned—cannot pursue their activities independently in pursuit of their microeconomic interest. Banking operations are subordinated to the needs of the economic plan, in which the overall and major structural developments are pre-determined. On the other hand, banking policy is in a sense a more powerful weapon because there is no short-term money market, no stock exchange and no “fringe” banking institutions (hire purchase companies, personal loan establishments, development financiers, building societies, etc.). All these functions are performed by the banking system, and its regulation provides an airtight control over the flow and distribution of finance.

### The Credit Plan

Under Socialism economic development is never allowed to be hampered by a lack of finance. If there are physical resources available and if the production is socially desirable, it goes without saying that the means of financing will be provided. The economic plan has a counterpart of the credit plan which is worked out by the central bank in co-operation with other banks.

The total amount of credit and the proportions allowed to different branches are, as before, centrally fixed according to the planned needs of the economy. But otherwise the microeconomic distribution is left to the judgement of the banks and enterprises concerned. Loans are extended on the condition of good management and the soundness of the purpose for which credit is sought. As under Capitalism, a distinction is made between short-term (also known as “turnover” or “production”) and long-term (“investment”) credits.

Short-term credits, particularly on commodity turnover, are not as important in Socialist countries as in the West. Trade credits on commodity turnover are extended only by banks, not by the selling enterprises. They are strictly regulated because they could easily interfere with the

planned utilization of resources. The same applies to credits in trade among Socialist countries—loans are granted by banks to the designated banks in the importing countries.

Consumer credit, which is extended only by savings banks and consumer co-operative shops, is as yet of much smaller importance than in the West, but its role is gradually increasing. The proportion of consumer goods sold on this basis is about one-tenth, but in Hungary it is as high as one-quarter. There are usually strict conditions imposed, such as that the borrower must be in regular employment and that the amount of credit must not exceed a certain proportion of the person's annual earnings (e.g. one-third in Yugoslavia).

In extending long-term credits emphasis is no longer on the sheer size of the projects but rather on their suitability and efficiency. Banks participate in planning investment ventures and evaluate their prospective profitability. Preference is given to the projects promising quick returns, those directly affecting exports and import-replacement production, and those intended for the less developed regions.

### Control over Users of Bank Funds

To ensure financial discipline, banks now have considerable powers of control over the users of bank funds. In case credits are not applied for the approved purpose, or the project is not completed on time, or if credits are not repaid on maturity banks can apply the following sanctions against the offending enterprises:

- ☐ charging penalty interest rates for the period originally approved;
- ☐ requiring the repayment of the credits before maturity;
- ☐ withholding the funds for wage and salary payments, especially for material incentives;
- ☐ refusing credits in the future (but enterprises can appeal to the arbitration court in such cases).

As the total amount of credit and its broad distribution are determined on a planned basis, it is obvious that interest cannot play such a decisive role as under Capitalism. However, although interest rates are of little significance in programming investment at the central level, they are now used as an important instrument of promoting the most efficient distribution and application of credits at the operational level.

Until the early 1960s a large proportion of the enterprises' investment needs in the European Socialist countries (except Yugoslavia) was met

by interest-free non-repayable grants from the State budget. But this practice only encouraged enterprises to place extravagant demands for larger and larger allocations, leading to an alarmingly increasing capital-output ratio and tremendous waste.

### Growing Importance of Interest

However, this wasteful practice has been almost completely discontinued since the mid-1960s by the introduction of annual capital charges. It is now recognized that interest is ideologically justified because capital is nothing else but materialized labour, and as such it should be rationally distributed, as it represents a means of economizing labour. In fact, there is nothing new about interest under Socialism—it existed even under Stalin. But it applied only to turn-over credits obtainable directly from banks; interest was also payable on personal savings deposits.

The capital charge in most of these countries is uniform for the whole economy. In Bulgaria it is 3 p.c. p.a. of the value of fixed assets, in Hungary it is 5 p.c., and in Poland 6 p.c. In Czechoslovakia the charge is levied on fixed capital, 6 p.c. p.a., and on circulating assets, 2 p.c. p.a. But

in some countries, the annual charges on fixed capital are differentiated according to industries—in the GDR they range from 1 p.c. to 6 p.c. p.a., and in the USSR from 3 p.c. to 9 p.c. p.a. The purpose is to regulate the profitability rate of different industries, which otherwise would differ greatly owing to the imperfect price structure. The differentiation of the rates is treated as temporary, and it is to disappear when the price structure is improved.

The rates of interest on bank credits are not determined in the free markets for loanable funds, but are still centrally fixed to suit a variety of objectives. The rates charged are now highly differentiated, reflecting the new flexible approach to credit policy. The ranges of interest rates p.a. at the beginning of 1969 (including penalty rates) are as follows—Bulgaria: 2–8 p.c., Czechoslovakia: 1.5–12 p.c., GDR: 1–12 p.c., Hungary: 2–16 p.c., Poland: 2–10 p.c., Rumania: 1–12 p.c., USSR: 0.5–8 p.c., Yugoslavia: 5–20 p.c.

To attract deposits from enterprises, institutions and individual persons, interest is payable by banks. For example, up to 7 p.c. p.a. is offered in Hungary and Yugoslavia on long-term deposits. Savings banks pay about 3 p.c. p.a. on personal deposits.

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