

Post-Reform Changes in Banking in Eastern Europe

The changes in banking in the countries of Eastern Europe following the reforms of economic management¹ which began to be introduced in 1965, consist mainly in shifting investment financing from non-returnable grants from the budget to long-term credit from the State Bank. Other important changes involve simplifying extension of credit for working capital purposes, widening the availability of credit to consumers, and the extension of activities of Banks for Foreign Trade. These changes have occurred in the Soviet Union as well as in all the smaller socialist countries of Eastern Europe. Because Yugoslavia had put into effect all these changes much earlier and has gone much further than the other socialist countries by creating a banking system that is geared to influencing a socialist market economy rather than to improving the functioning of a centrally-directed economy, this article will not include developments in Yugoslavia, which have been reviewed by R. Goldsmith in a recent issue; neither will it make reference to Albania, because of lack of adequate information.

1. - The evolution of the banking systems of the smaller socialist countries since World War II followed an almost identical pattern. Immediately following the establishment of "people's democracies", the entire commercial banking system of each country was nationalized, and commercial banks were merged with the central bank to form the "monobank" under the name of National or State Bank of the given country. Savings Banks, to the extent that they did not already form a national network, were integrated into one single system, which in some cases also incorporated cooperative or other savings institutions. Some specialized banks were created or continued to operate after being nationalized. Thus, within a few

¹ See "Banking and Credit in the Framework of New Economic Policies in Eastern Europe", this *Review*, September 1966.

short years after the establishment of a communist government, the banking structure of each country became a replica of the Soviet "standard system".²

Between the establishment of the "people's democracies" in Eastern Europe in the late 1940s and the wave of economic reforms in the middle 1960s, organizational changes in banking involved mainly merging some specialized institutions into the State (National) Banks, following similar moves in the Soviet Union. An example is the abolition of the Agricultural Bank and of the Bank for Cooperatives in Hungary.

While the institutions in charge of disbursing budgetary and other resources for fixed investment on a grant basis are, in fact, administrative and supervisory agencies rather than banks, they operated in Eastern Europe under the guise of banks and carry the word "bank" in their name. Such investment banks had been created in each country of Eastern Europe as soon as they adopted the Soviet economic system. In some of them (as in Hungary and Poland) in certain periods they also received funds from the State Bank.

Thus, prior to the reforms, the monobank system of all countries of Eastern Europe comprised (1) a State bank, which combined monetary powers and operated a nationwide credit transfer system, extended short-term credit to the socialized sector of the economy and collected and disbursed all government revenue, including investment funds ultimately dispensed by the Investment bank; (2) a savings bank system to service the population; and (3) a Foreign Trade Bank. Most countries had, at one time or another, also one or more specialized institutions to serve specific segments of the economy.

When confronted with either organizational or procedural changes in socialist economies, it is not always easy to distinguish between substance and superficial rearrangements undertaken for a variety of reasons which do not greatly affect the functional relationships or the seat of final authority. The most important of the changes introduced by the economic reforms is a case in point. The shift to a combination of credit and self-financing of fixed

² For a description of the standard system and of the monobank as its keystone, see my *Money, Banking and Credit in Eastern Europe*, Federal Reserve Bank of New York, 1968 which also contains brief descriptions of the banking system of each country.

capital investments, with non-returnable grants now limited in the main to *de novo* projects and to enterprises which do not operate profitably, but are continued in operation for national defense or other reasons (such as to fulfill long-term contracts with other countries), involves essentially a rechanneling of financial flows, without any significant decentralization of investment decisions. It does not necessarily increase substantially the authority of the individual production units (enterprises) to initiate investment decisions and to make final choices on the technological processes and raw materials to be used and the location and scale of production (and even less — disposition of output). It represents essentially a restructuring of flows of funds available (or “planned”) for investment by considerably increasing the proportion of profits that are either self-invested or to be used to repay investment loans obtained from the banking system (State Bank or Foreign Trade Bank, in the case of foreign exchange loans; see below). This reform reduces considerably the volume of the circular flow of enterprise profits: budget (taxes) — Investment Bank — enterprise investment — enterprise profits. It creates an additional circuit — bank investment loans — enterprise profits — loan amortization. The main result of this rechanneling is a shrinkage of the budget (all other elements remaining the same) and a corresponding enlargement of the balance sheet of the State (Foreign Trade) Bank. In fact, a revolving investment fund administered by the State Bank has replaced part of the grants which previously disappeared from the financial circuit once the budgetary funds were transformed into “own” funds of the enterprise. On the other hand, it creates new repayment commitments instead of merely increasing the flow of profits into the budget, as before.³

A variety of methods is being used to institutionalize techniques of arriving at an optimum use of investment funds without the guiding hand of the market mechanism.⁴ Some countries follow

³ Similarly, the enlargement of lending by the Savings Banks reduced the circuitous flows to the extent that funds collected by these institutions are no longer channeled to the State Bank (in some countries — the budget) which financed household purchases indirectly by making loans to retail stores for the purpose of granting consumer credit.

⁴ To achieve greater flexibility in the importation of capital goods, Czechoslovakia introduced in 1967 multiple foreign exchange coefficients, and by 1971 all countries other than the Soviet Union used multiple exchange rates under various names by applying surcharges and subsidies in establishing domestic equivalents of foreign currency costs of capital goods and, in most cases, of some other goods as well.

to a certain extent the early Yugoslav example of auctions for such funds, while others set minimum rates of return that must be met or exceeded to obtain such loans. Thus, Hungary established in 1972 an average rate of return of 15 per cent, with lower rates for certain industries in which expansion of output is particularly desirable, such as those producing building materials, and for agriculture (7 per cent in both cases).

The table below shows that by 1970 the role of credit as a source of investment funds had risen sharply in all countries except in East Germany, where it was much higher than elsewhere in 1965.

SOURCES OF FINANCING GROSS FIXED INVESTMENT IN EASTERN EUROPE
(in per cent of total)

	Budget	Own Funds	Credit
<i>Bulgaria</i>			
1965	70	24	6
1970	25	44	31
<i>Czechoslovakia</i>			
1965	69	23	8
1970	17	61	22
<i>East Germany</i>			
1965	11	64	25
1970	10	63	27
<i>Hungary</i>			
1965	76	23	1
1970	53	37	10
<i>Poland</i>			
1965	46	45	9
1970	18	36	46
<i>Rumania</i>			
1965	61	37	2
1970	37	56	7

Source: N. MITROFANOVA: "Tendencies in financing and the use of credit in the European socialist countries which are members of COMECON", *Dengi i Kredit*, December 1972 (in Russian).

For slightly different estimates for 1965 and data for 1968 and 1969, see H. F. BUCK, "Post War Trends in Eastern European Banking" in *Colloquium on Money, Banking and Credit in Eastern Europe*, Yves Lulan, ed., NATO, Bruxelles, 1973.

The share of credit remained still modest in 1970 in Hungary and Rumania, where the shift since 1965 has been mostly toward financing from own resources. But this shift was even more pronounced in Bulgaria and Czechoslovakia, reaching in the latter country almost the same high percentage as in East Germany — nearly two thirds of the total. Except for East Germany, which had restructured its flow of investment funds much earlier than the other countries, the decline of the role of the budget as a source of investment funds for the economy has been dramatic. By contrast, in the Soviet Union the share of credit remained negligible ($\frac{1}{2}$ per cent) as late as 1969.

In a parallel development, the participation of short-term credit in meeting enterprises' working capital needs has been increased, and meeting such needs from the unit's own profits has increased, with the result that the claim on the budget for "reinforcing" working capital needs as production expanded has been decreased (but in Hungary such enlargement of working capital was undertaken as late as 1971).

2. - Another significant change in the wake of the reform has been greater reliance on interest rates as a tool for influencing the use of credit. The low interest rates typical of the original monobank policies reflected the purely implementary character of credit and the narrow range within which individual enterprises control the main source of need for short-term credit — inventories. To the extent that one of the purposes of the reform was to shift from purely administrative controls to financial incentives, credit terms became more differentiated, with regard to the purpose as well as maturity of the loan. Differentiation between more and less profitable (efficient) units became a more important consideration in granting credit.

The move away from automatism and excessive compartmentalization of credit extension for working capital purposes (except for expediting collections) has characterized recent developments in all countries of Eastern Europe and in the Soviet Union. In some countries it was an integral part of reforms designed to substitute indicative for integral planning and to place more reliance on decentralized decision-making. In several other countries and to a lesser degree in the Soviet Union, it was the result of the growing role assigned to credit in the financing of investments and the resulting opportunity, and even need, to coordinate lending of

various maturities and purposes to the same enterprise or industry association. Similar principles of efficient use of borrowed funds are now being applied to loans for working capital and fixed investment purposes, while the need for paring down investment loans gives bank management more opportunities for introducing project and performance appraisal tests and procedures that are quite superior to those used — frequently in a perfunctory manner, and by administrative agencies rather than by bank officials — when budgetary grants were in fact the only source of outside financing.⁵ The extent to which the shift to greater use of credit in the investment area has benefited administration of credit varies among countries, as does the extent to which interest rate differentiation is used as a tool of credit policy. A differentiated rate structure is, no doubt, superior to the narrow and immutable range of rates typical of the standard system, while a higher average level of rates encourages a more economic use of outside funds. But flexible rates are not the same as differentiated rates; the authority of bank officers on the firing line to determine or to negotiate rates for individual credits is still very limited in all countries of Eastern Europe and practically nonexistent over a wide range of credit extensions.

Penalty rates have become stiffer and are now reinforced more vigorously. They usually rise with each subsequent loan extension; approval or even guarantee of the supervising ministry or industry association is usually required to obtain such extensions. The extent to which the State Bank compels the borrower to adhere closely to loan terms and formalizes bank-enterprise relationships through credit contracts which are similar to credit lines (provided the borrower achieves stipulated production and cost objectives) differs from country to country. In some countries (as in Hungary) such contracts have not proven workable and have been replaced by more general “framework contracts”.

The considerable expansion of long-term lending made the rate charged on such loans an important element of cost. Another significant aspect of the rate on such loans is that it represents something like a minimum socially acceptable return on fixed capital and thus identifies as undesirable projects that cannot afford to pay this rate. Since the shift toward loan financing of investments began,

⁵ In Poland, at the end of 1973, 43 per cent of all bank credit to the socialized sector was for investment purposes, as compared with only 20 per cent in the Soviet Union.

there has been a general tendency to raise the basic rate on such credits (which in East Germany, for instance, went from the initial 1.8 per cent in 1964 to 5 per cent in 1970 and in other countries generally from 5 to 6 per cent and more), to reduce considerably the range of industries or purposes for which lower rates apply and to move the rates on working capital loans closer to those charged on investment loans.

Similarly, on the deposit side, there has been a tendency to encourage longer-term deposits of enterprises and other economic units by raising rates on time deposits in comparison to those available on sight deposits (which in some countries have been abolished) and by stepping up these rates in relation to maturity. Similarly, rate structures available at savings banks have been differentiated. Interest rates payable on sight accounts are now typically lower than those offered on term deposits (which in Poland, for instance, range from 3.5 to 5 per cent, depending on maturity). New types of account that are more attractive generally or to specific groups of the population have been introduced in many countries.

While in the smaller socialist countries rate differentiation is increasingly related to maturity and industry (with a tendency to reduce the range of those enjoying favorable rates) rather than purpose, in the Soviet Union changes in rate structure still remain largely geared to plan fulfillment. Thus a higher (8 per cent) rate was introduced at the beginning of 1974 for loans to carry inventories exceeding planned amounts. Rates on loans for various working capital purposes remain low in the Soviet Union where they account for about half of the working capital (as compared with about 70 per cent in Eastern Germany). It is reasoned, for instance, that no economic purpose would be served by raising the rate (currently 2 per cent) on loans made to speed up payments, even though some Soviet economists are arguing that it should be as high as 8 per cent. Reasons put forward by some Soviet economists to raise the basic rate on inventory loans to as high as 6 per cent, but at least to 3 per cent (they are still being made at 1 or 2 per cent in many cases) have so far gone unheeded. Thus credit to organisations in charge of purchasing farm output and its processing is still available at 2 per cent.

Yet, in August 1973 various changes in the level and structure of interest rates were made with the general purpose of using credit terms more efficiently as a means of stimulating introduction of new

technology and to reduce excessive holdings of inventories. The maturity of various categories of working capital loans has been extended considerably (in some cases to up to three years), even in the case of inventories carried in excess of stipulated ("planned") levels if the additional accumulations are related to the introduction of new products or lines. Several of the significant interest rates have been raised. Thus the traditional view that rates on loans made in connection with the collection process should be nominal (since speed of collection does not depend on the seller) has been dropped and the applicable rate raised from 2 to 4 per cent and even to 7 per cent if credit is required for more than 30 days.⁶

Instead of summarizing rate changes in individual countries, it might be more useful to review in greater detail those made in the largest of the socialist countries outside the Soviet Union. In Poland, where at the time when the economic reforms were introduced interest rates on loans for investment purposes ranged between 1 and 3 per cent, they were raised to a basic 5 per cent and at the beginning of 1974 to 8 per cent, with a lower 3 per cent rate applicable to extractive industries. Yet very low rates continue to be available for certain purposes, such as investment in farming and for cooperative housing construction. Cooperatives erecting multi-dwelling units are still charged only 1 per cent per annum, while one-family homes can be financed (for 20 per cent of the total cost only) at rates ranging between 3 and 6 per cent, depending on the cost of the house.

The basic rate on working capital loans, which was 4 per cent when the reforms started, was raised at the beginning of 1974 to 6 per cent for enterprises operating under the new system, with a $\frac{1}{2}$ per cent to 2 per cent commission, depending on loan maturity added in certain instances. The principle that the basic rate applies only to enterprises which carry a predetermined part of inventory (normally 40 per cent) on credit and that lower rates apply to those which are able to carry a higher proportion with their own funds

⁶ Correspondingly, the rate on advances on drafts in collection channels has been doubled. Rates on loans overdue may now go as high as 10 per cent, and some of the bank-imposed penalties for non-compliance with payment regulations, which are peculiar to the Soviet banking system, have been raised sharply (such as a penalty levied for submitting bills for goods not actually shipped or for using goods received before settling the related bills), as have been the penalties which the bank pays to the enterprise for making accounting errors.

has been retained (enterprises requiring more credit paying up to 10 per cent). Yet, again, considerably lower rates are available to industries judged to deserve special stimulation, such as those engaged in exporting (from 3 down to 1½ on export bills discounted!) and in construction (2 per cent). Consumer credit rates are differentiated according to the maturity of the contract (from 6 to 36 months) and range between 3 and 9 per cent.

In the endeavor to attenuate the traditional rigidity and uniformity of interest rates, various techniques have been introduced or generalized, such as raising in some instances the cost of credit by collecting "commissions" at variable rates, by giving the minister of Finance the authority to waive such commissions in some cases, and by rebating rates in the case of repayment before contractual maturity (as in the case of housing loans).

3. - The organizational counterpart of the restructuring of financial flows has been the abolition of investment banks and the transfer of their activities, mainly to the national banks.⁷ Financing of home building has been typically transferred to Savings Banks, and in Poland — the only country in which an Agricultural Bank survives — investment financing of food and forestry industries has been shifted to the Agricultural Bank (Bank Rolny). Only in the Soviet Union, in which budget grants still remain the main source of investment funds and bank credit (except in agriculture) still is marginal, and in Rumania, did an independent Investment Bank survive.

At the time of the abolition of the Investment Bank in Hungary, a new Development Bank was created, mainly for the purpose of providing initial fixed capital for new enterprises and industry associations. It is operating very much like its predecessor (although in a much narrower field) and under close control of the Ministry of Finance.

Otherwise, organizational changes have been of a marginal nature, except in foreign banking, to which the following section is devoted, and for shifting, in several countries, of the supervision of the expanded savings bank system from the Ministry of Finance

⁷ The investment banks were merged into the State Bank as early as 1959 in Czechoslovakia, in Bulgaria in 1967, in Poland in 1969, and in Hungary in 1971. In the German Democratic Republic, the Investment Bank was merged into the Industry and Trade Bank (see below) created in 1968.

to the State Bank. The other institutions outside the monobank have been generally continued in the form in which they emerged after the reorganization of financial institutions in the years immediately following the end of World War II.⁸

Some of these credit institutions were continued⁹ either because of the historical role which they had played prior to World War II or because it was recognized that they met special needs to which a centralized State Bank could or would not respond. These institutions involved mostly networks of rural cooperative or savings banks (Germany, Poland, Hungary). Activities of these institutions have not been curtailed subsequently but, rather, expanded to encourage farm production on individual lots managed outside collective farms, as well as independent craftsmen and repairmen in countries where such activities enjoy official stimulus.¹⁰

4. - The growth and diversification of foreign trade, in particular with non-socialist countries, has required considerable development of foreign banking facilities. The activities of the Foreign Trade Banks, which, except for Poland, had evolved from the foreign departments of the State Bank, have become more diversified and complex.

From a structural point of view, the splitting off of foreign business from the State Bank was completed within the COMECON group of countries by the creation of a Bank for Foreign Trade in Rumania in 1967. The greater involvement abroad of the banks of these countries caused them to extend their network of foreign

⁸ In some countries, such as Rumania, the Reform was not accompanied by any changes in structure.

⁹ Only the banking system of the smallest of the socialist countries has undergone some temporary change following the introduction of economic reforms. A Foreign Trade Bank was started in Bulgaria in 1964. Then the Investment Bank was merged into the National Bank at the beginning of 1967 and simultaneously the Savings Bank, placed under the supervision of the National Bank, was enlarged. A special Maritime Trade Bank, created as part of a grouping of industry associations in the shipbuilding and shipping area was merged already in 1969 — after a short existence — into the Foreign Trade Bank. Then two credit banks (one for industry and the other for agriculture) were created in 1969, but merged two years later into the National Bank. As a result, the Bulgarian banking system now conforms to the post-Reform pattern of financial institutions common to most countries of Eastern Europe.

¹⁰ The "Enterprise for Instalment Sales" (in fact, a counterpart of sales finance companies operating in many Western countries) created in Poland when consumer credit was introduced was liquidated and its activities transferred to the Savings Bank effective January 1, 1970.

branches and to create new institutions jointly with banks from non-socialist countries, such as the Banque Franco-Roumaine in Paris.

Since 1973, first the Soviet Union and, subsequently, Hungary and Poland, have admitted representative offices of a few leading commercial banks of the U.S. and of several European countries. While, in the framework of the banking monopoly, to which all socialist countries continue to adhere, such offices cannot transact regular banking business, they serve as conduits for business to their head (or other foreign) offices and service their customers in making contacts and completing deals in the socialist countries. In their relations with non-socialist countries, the advent of floating rates has required greater sophistication and maneuvering in the management of foreign exchange flows and reserves. The introduction of multi-lateral clearings among the socialist countries with the creation of the International Bank of Economic Cooperation (IBEC) in 1964, the greater use of credit in bridging payments gaps within this framework and the integration of the clearings of non-trade transactions, to which different exchange rates apply, increased the scope of the activities of the foreign trade banks.

Similarly, the creation in 1971 of the International Investment Bank (IIB) to foster multi-country investment projects within the COMECON made foreign trade banks the conduit for the long-term credit flows among these countries (which undertake them as an agent and on the instruction of the State Banks). A new field has been opened to their activities since the pioneering entry of the National Bank of Hungary as a borrower into the Eurobond market, followed in December 1974 by the Bank for Foreign Trade of the USSR which borrowed for a term of five years.

Domestic operations of the foreign trade banks are likely to grow as exports to non-socialist countries continue to expand and the types and volume of credit extended to domestic producers of export goods is increased. Multiplication of domestic branches of foreign trade banks (which, in the case of the Soviet Union, until 1971 had only one branch outside of Moscow) is another related development.

Needless to add, that greatly expanded foreign activities, which require familiarity with financial structure and procedures in foreign countries, maintenance of correspondence relationships around the globe and personnel training with the assistance of foreign commercial

banks have greatly expanded the horizon of bankers in socialist countries, in particular in the Soviet Union and in three of the smaller countries in which prior to World War II much of the foreign business was in the hands of foreign-owned banks.

5. - The rapid rise of household savings, the greater availability of durable goods and the growth of domestic travel during the last decade have required expansion of facilities and creation of new means of servicing the payments needs of the population.¹¹ The evolution of the savings bank system into a network of fully staffed offices to serve a growing range of savings and payments needs of the population and to relieve the State Bank from handling accounts of municipalities and various public organizations, in particular of those of a local character, has occurred in several countries. Savings banks have generally extended the range of lending to the population, which normally includes financing of purchases of durable consumer goods (which may include clothing, but usually, at least until very recently, excluded cars), and in financing building of individual houses and of cooperative apartments.¹² At the same time, the importance of some of the original functions performed by savings banks in most countries of Eastern Europe has declined. Thus, the attraction of special-purpose accounts entitling their holders to the purchase of scarce goods declined as such items became more plentiful. Similarly, the popularity of lotteries with merchandise prizes declined. In general, there has been a tendency to rely less on non-monetary features and more on differentiation of interest rates by maturity. While savings banks generally continue to act as a primary redemption agent for internal government loans, their function is no longer primarily to collect consumer savings for automatic transfer to budget receipts. More and more savings bank deposits are used as a source of funds for financing consumer purchases and of housing.

Given the growing importance of its lending operations, the

¹¹ In Poland with its large number of emigrants around the world, a special organisation, not classified as a bank because it does not make loans, the Bank Polska Opieki, provides foreign exchange services to the population.

¹² While for a long time the main purpose of savings bank operations was to absorb the largest possible amount of consumer purchasing power, with the rapid growth of savings deposits in recent years in all socialist countries more attention is being paid to the cost of operating the savings bank system. Thus it was found in Poland that the prevailing deposit and lending interest rate structure resulted in a 2 per cent loss on each loan made. As a result, interest rates on loans were raised in 1973.

savings bank system has been transferred in several countries (Soviet Union, Rumania, and Bulgaria) to the State Bank, typically as a fairly independent unit (acknowledged in the Soviet Union by the creation in 1973 of a separate Board to direct the savings bank activities). Elsewhere it is independent but supervised by the Ministry of Finance. In effect it is a single savings bank system, into which all savings institutions and the postal savings system have been merged. Only East Germany continues to have a network of separate municipal savings banks.

In Czechoslovakia savings banks have begun in 1973 to open checking accounts for individuals (following the example of East Germany by a decade and that of Poland), and, in general, savings banks have endeavoured to widen the range of payment services offered to the population. In general, Savings Banks have developed credit transfer systems, with facilities for depositors to make withdrawals at offices other than the one in which they hold their account have been gradually expanded. In several countries, the growth of household savings has resulted in the expansion — alongside of those of savings banks — of activities of mutual credit associations attached to trade union organizations in individual factories and other places of work.

6. - The motives underlying various attempts to transform the State Bank into a central bank and to transfer its other functions to specialized credit banks were, presumably, varied, but after considerable discussion and even drafting of legislation, whatever moves have been actually made in this direction have actually taken place within the structure of the monobank. In some countries, no doubt, greater exposure to the banking experience of non-socialist countries, or even the thought that by transforming the State Bank into a bankers' bank greater scope for monetary policy and increased use of market mechanisms could be obtained, played a role. This was, possibly, the case in Rumania where at a National Conference of the Communist Party held at the end of 1971 a project was actually endorsed which foresaw establishment of credit banks for specific branches of industry. In Czechoslovakia a bill providing for the transformation of the State Bank into a central bank, together with the creation of separate credit banks for Bohemia and Slovakia, was prepared as part of the general decentralization move just prior to the occupation by Soviet troops. It was not put into effect. The Banking Act that

became effective at the beginning of 1971 merely provided for separate "Head offices" for the two component republics of Czechoslovakia under a common "Central office" of the State Bank. The same Act extended somewhat the monetary powers of the State Bank and its authority in the field of foreign exchange, but no provision was made for the separation of central bank functions from lending to the economy.

Such separation has been discussed in several countries (but not, at least overtly, in the Soviet Union); it would be entirely compatible with continuing the present basic principles of socialist monetary management, including planned expansion of credit and of the money supply. A sweeping banking reform became effective in East Germany at the beginning of 1968 as a result of which the State Bank took over the central banking functions of the former Bank of Issue. At the same time a new Industry and Trade Bank was created from the other departments of the Bank of Issue and the Investment Bank to meet the working and long-term investment financing needs of the economy, except agriculture and the food industry, which are served by a separate bank.

In Poland, with agriculture remaining a private sector and exports representing a relatively large part of the national product, the National Bank has for many years refinanced both the Agricultural Bank and the Commercial Bank (*Bank Handlowy*), thus being the only monobank to engage in significant rediscount operation similar to those routinely undertaken by the central banks of the non-socialist countries. In 1969, as much as one-third of total credit (but a much smaller proportion in other recent years) granted by the National Bank of Poland was through refinancing. Moreover, the Agricultural Bank in its turn is acting as a central bank for a wide network of farm credit cooperatives. At the present time, East Germany is, however, the only socialist country in Europe that has credit banks which are supervised and directed by a central bank. In most other countries of Eastern Europe, the division of functions within the monobank has been merely made more explicit by grouping central bank policy departments within the State Bank — thus creating a central bank component (which also directs the activities of the Bank for Foreign Trade) within the Bank and at the same time restructuring the credit departments along industry lines (where it had not been already done earlier). The credit department is thus transformed into a collection of industry-branch banks

operating under one roof, but using the national network of regional and local offices for the paperwork involved in lending operations (a parallel may be found in the similar use of State Bank offices as agents for the Bank for Foreign Trade where it does not have an office).

Formation of industry branch directorates at the State Bank headquarters does not necessarily mean centralization of actual lending, since, depending on the country, they act merely as planning, coordinating, and supervisory groups and/or as links to industry associations.

Industry-branch organisation of the head offices of the various State Banks was also fostered by the transfer of long-term lending (and its rising importance in relation to other sources of investment funds) to the State Bank and the resulting desirability of coordinating all lending to each enterprise or "industry association" (horizontal, and, sometimes, also vertical groupings of enterprises of regional or national scope).

The industry-branch structure was also carried to various degrees to the regional and local offices, in particular in the Soviet Union.

While routine operations which in some countries are now largely handled by computers still represent a very large part of the monobank day-by-day activities, none of the countries of Eastern Europe has followed the example of Yugoslavia in transferring the entry of credit and debt operations on the accounts of bank customers to a separate "social accounting center", although in the Soviet Union, and in some other countries, separate account processing centers have been created within the monobank.

Preservation of the monobank structure does not rule out considerable progress toward creating and developing, within the State Bank, of staffs of analysts and senior officials who focus on macro-economic problems and on the coordination of monetary measures with various policies designed to achieve growth (plan) goals with a minimum inflationary impact.

Taken together, (1) the transfer of a large part of the allocation of investment funds to the banking system, which constitutes the most important, although to a large extent only superficial, restructuring of the standard financial system; (2) and the expansion of the savings banks into a full-service banking system for the population (and in some countries — also for servicing the non-socialized sector), and (3) placing of all foreign payments and other foreign financial

relations in the Foreign Trade Banks, which have acquired greater internal independence as well as generally a high standing abroad, represent important developments even though they have not involved any basic change in the role played by the monobank.

Whether the means available to the monobank and their actual use, together with the limitations imposed on the role of money and credit within the framework of a centrally planned and administered economy, rule out the emergence of a distinct "socialist monetary policy" has been much debated among economists specializing in Soviet-type economies. Some of the difficulty is in the underlying assumption that monetary policy aims primarily at controlling aggregate *demand*, and that it is doing it by influencing the cost and availability of bank reserves and of credit. Clearly, when the volume of both the money supply and of credit is determined directly (administratively, with reference to objectives of physical and financial planning rather than through the reserve mechanism), the question whether planning of the annual growth of the money supply and in credit constitutes "policy" is largely academic. But evolution of banking policies since the introduction of the reforms of the mid-sixties suggests that such policies have some scope in influencing aggregate *supply*. Breaking away from the original rigidity and automatism in extending credit, monobanks of the various countries (and Banks for Foreign Trade within their respective spheres of activity) have come to place greater emphasis on differential (more favorable) terms available to the more profitable enterprises and on efficiency-promoting credit. At the same time, liquidity has become a less important factor in judging enterprise performance, while lending to producers operating on the margin of the socialist economy (such as handicraft industries, independent farmers) are now receiving more credit than before the reforms were initiated. The greater orientation of credit toward raising productivity and increasing aggregate output (and improving its quality) tends to transform monobank lending from credit administration into credit policy, with considerably more discretion left to the banking office actually processing the loan application than before.

How far this process has gone in individual countries is difficult to judge, in part because of the emergence of "industry associations" as an intermediate link between individual enterprises and industry ministries. Under the "standard system", credit actually available to individual economic units (enterprises) depended in the

last instance, on the Ministry by which it was supervised. This dependence was evidenced in the financial planning which implemented the enterprises' production targets and the direct intervention of the ministry (or its industrial subdivision — such as the *Glavk* in the USSR) in guaranteeing loan repayment, channeling additional working capital from the budget to the enterprises, in transferring, at times, excessive cash balances to other units under its supervision and in controlling the use of amortization funds and various forms of “decentralized investment”. The associations — in general — have taken over many of the functions previously exercised by ministries which, however, are retaining most of the means of financial intervention available to them. It is still not clear to what extent and in what countries they are to serve, in fact, as a conduit of credit between the bank and the individual enterprises and to what extent they can, and actually do, provide funds in case the bank refuses them. A decision by the Council of Ministers of the USSR taken in March 1973 suggests a shift in channelling the bulk of credit from enterprises to associations. But even merely a shift of the financial buffer function from ministries to associations operating on a business (“*khozraschet*”) principle is bound to reinforce efforts to make extension of credit a significant tool for expanding aggregate output and for influencing the pattern of its growth. Through greater differentiation of interest rates, attempts to reduce subsidies designed to keep unprofitable units in production and more general and rigorous enforcement of sanctions (many of which were available but not actually used earlier), considerable strides have been made in several countries of Eastern Europe toward developing a monetary policy.

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