CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

PART I

Background information

© in this web service Cambridge University Press www.cambridge.org

CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

1

Monetary control: meaning, problems of comparative treatment, some relevant Western concepts

Some difficulties of comparative treatment of monetary control

It is not possible in a single book to present all aspects of money and banking in a reasonably advanced economy. This study thus focuses on certain important aspects of socialist money and banking. As until recently the socialist banking systems were essentially short-term credit suppliers, much attention is given to problems of monetary control. Throughout the book the treatment of monetary control (based on short-term credit) is separate from credit finance and control of investment. It may be useful at the outset to make clear what is understood by monetary control and what aspects of money receive less attention.

The same basic problem of national economic management faces both Western and socialist economies. It is the selection of priorities from among a multitude of possible economic objectives and the consequent adoption of policies designed to apportion scarce means to achieve them. Economic calculations of one kind or another must be made in the solution of this problem. Money as a standard of measurement is used in both types of economies, but the measurement of values for purposes of decision taking is different. It is not so much money but prices which reflect value, especially in a market economy. Money is merely the 'third commodity' (due often to its general acceptability as a means of exchange), which serves as a common denominator reducing heterogeneous commodities to uniformly denominated units, thus facilitating economic calculations. But, to explain why differing amounts of, for instance, apples and bread, pig iron and tractors, effort of miners and teachers, are exchanged per unit of money, one would have to examine forces going well beyond the subject of money, however defined. Furthermore, decision taking by the entrepreneur (who may be a 'firm' or a 'central

© in this web service Cambridge University Press www.cambridge.org

CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

planner') may well depend not merely on the availability of money, or a system of relative prices and its reliability for purposes of resource allocation, but also on such factors as accounting systems, conventions used in costing, and non-economic considerations based on political or ideological convictions. Thus in a money economy, regardless of whether it is socialist or capitalist, almost every economic act is in some way connected with money. Such vital economic activities as price formation and entrepreneurial decision taking in particular may be regarded as constituting a part of monetary management. Here, however, money would be only one among many factors, and in many cases it is its technical aspects (as unit of measurement, means of exchange, store of value) which would be relevant.

Issues of the definition of money, of its technical functions, of price formation and of decision-taking processes are not the prime objects of this study, though they are not irrelevant and do receive some consideration. One of its essential objects is to investigate the use made of some monetary variables, mainly bank credit and interest rates, in socialist national economic management. Thus, in terms of institutions, the study concentrates mainly on the relationships between the banking sector and other institutions in a socialist economy, chiefly enterprises. The view is taken that an analysis of the relationships which subsist in socialist planning between banks, as institutions charged with the task of manipulating monetary variables, and enterprises, as units which are the ultimate allocators of resources, not only allows us to make propositions about the efficacy of monetary control, but also throws some light on the nature of money and the way in which it fulfils its various technical functions. The study is, therefore, in no way intended to present a fully comprehensive account of money in a socialist economy; it is only intended to elaborate in detail one of its aspects, that connected with monetary control. Its other aspects are investigated only in so far as they are relevant to the main theme of monetary control as defined above.

An attempt is also made to compare socialist monetary control with that in Western economies, especially the UK. This, in conjunction with the fact that it was thought wise to consider socialist monetary control in various settings at different points in history, produces serious difficulties of presentation.

Money in the context of monetary control has been among the most controversial subjects in economics. One of its difficulties is

© in this web service Cambridge University Press www.cambridge.org

CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

that whereas economics, and in particular Western economics, has sought to discover some generally applicable principles of money and monetary control, financial markets, which in relatively developed economies generate claims considered to constitute money supply, are continuously changing. Just as no two economies are the same, no two financial markets are the same and it may well be that, though we may expect some common regularities to occur in diverse economies,[1] we may not have a generally applicable theory of money and monetary control. Their nature would differ with such underlying factors as the nature of the economic system and the level and the policy of economic development. In view of this it has been decided to present the subject of socialist banking and monetary control in historical perspective, by analysing its general strategy, its tactics and its efficacy in various stages of economic development. An additional reason for this approach is that political and administrative factors play an important part in socialist monetary management. Government decisions are often of greater importance in socialist management than the observed propensities or regularities of social and economic behaviour which form the basis of Western economic theorising. It is interesting to observe how government decisions have affected, or have been affected by, monetary considerations over a period of time.

An attempt has been made to anchor the analysis of socialist monetary control and institutions to well known propositions found in Western monetary economics. It is hoped that this adds to the clarity of analysis, makes it more palatable to Western economists and shows that, in spite of considerable differences in the economic systems, some Western concepts may be usefully deployed in analysing socialist money and banking. Indeed, particular attention is paid to those elements which occur in both socialist and Western monetary control.

This type of comparative treatment, however, is difficult not simply because we are dealing with different economic systems, but also because of differences in economic theorising and because there are no universally accepted views on the nature of money and

[1] In an interesting study (*Financial Structure and Development*, Yale, 1969) R. W. Goldsmith discovered a number of 'regularities' in the financial development of various countries. The study is, however, confined mainly to non-communist economies, and the author doubts whether the study enables us to formulate a truly general theory of financial development.

© in this web service Cambridge University Press www.cambridge.org

CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

monetary policy in the West, in spite of a great upsurge in research, discussion and enquiry (Radcliffe Committee in the UK, Commission on Money and Credit in the USA, Royal Commission on Banking and Finance in Canada) on the workings of monetary systems in the late fifties and in the sixties. The Western economist has been keenly interested in the theoretical foundations of monetary control, whereas the East European economist has tended to give priority to the explanation of some officially accepted principles of monetary control and to the implementation of these in national economic administration. Indeed a hint of the theoretical basis of Soviet-type monetary management has been given by Western economists writing on Soviet monetary affairs.

A superficial review of the theoretical foundations of Western monetary control

Before elaborating the last proposition it may be useful to take as a starting point the Western monetary theories to which references are made in the text. For our purposes the state of Western monetary debate may be summarised, indulging quite obviously in gross oversimplification, by reference to three broad groups of theories: (*A*) those based on the concept of exogenous money supply, (*B*) those treating money supply as an endogenous variable and (*C*) those postulating the need to control the total flow of credit, rather than some strictly defined stock of money.

(*A*) Much monetary theorising in the West has been concerned not with the technical functions of money mentioned earlier, but with the search for a monetary variable M, over which monetary authorities have full control, enabling them to affect the level of aggregate demand. The most generally accepted theories, including the Keynesian and quantity theories, take the view that 'money matters', money (viz. variable M) being currency and bank deposits. The key propositions of such theories are that money supply is an exogenous variable and that the money demand function (whether in terms of a relatively simple Keynesian liquidity preference schedule or a more complex function regarding money as one of a number of ways of holding wealth) is stable, enabling us to predict the effects of changes in money supply. The most debatable issues in these theories concern the explanation of the way in which changes in money variables affect real variables. For instance, the mechanism

© in this web service Cambridge University Press www.cambridge.org

CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

which translates monetary changes into real changes is clearly specified in Keynesian models, but has some serious weaknesses (e.g. the simplicity of the liquidity preference, the interest elasticity of investment demand); quantity theorists, relying mainly on observation (and testing based on regression and correlation techniques), propose causation going from the variable *M* to real variables, without convincingly explaining the mechanics of causation. Though the nature of the transmission mechanism of causation from *M* to real variables has by no means been resolved, the views discussed here have provided the theoretical foundations of monetary policy in many western countries, including the UK.

(*B*) There have, however, always been economists who disputed the exogenous nature of money supply, and its power to affect real variables, claiming that money adjusts to the requirements of the economy. They deny the validity of monetary causes of economic disturbances and the potency of monetary control over aggregate spending. Such views may broadly be identified with the nineteenth-century Banking School of monetary theory, whose present-day supporters may be said to be J. R. Hicks and N. Kaldor.[1] More is said about this approach to monetary economics later, as it has some relevance to monetary control in socialist economies.

(*C*) The third group of monetary theories is really a variation of the preceding one. The great difficulty of defining money (variable *M*) is strongly emphasised. It is held that, of the large number of claims existing in an economy, it is difficult to single out those which may indisputably be defined as money. Furthermore, control of *M* as defined above makes little or no impact on aggregate demand, because control over bank credit is easily offset by a net (viz. over and above savings flowing into financial institutions) expansion of credit from other sources (non-bank intermediaries, trade credit). Thus monetary policy based on the control of money supply is frustrated by a compensatory creation of claims which are good substitutes for money conventionally defined. The policy prescription based on such theories, which in England may be identified with the Radcliffe Committee and R. S. Sayers,[2] is that monetary

[1] J. R. Hicks, *Critical Essays in Monetary Theory* (Oxford, 1967) esp. chs. 1–3; N. Kaldor, 'The new monetarism', *Lloyds Bank Review*, no. 97, July 1970.

[2] *Committee on the Working of the Monetary System* (HMSO: London, 1969); R. S. Sayers, 'Monetary thought and monetary policy in England', *Economic Journal*, December 1960.

© in this web service Cambridge University Press www.cambridge.org

CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

authorities must control the total flow of credit ('general liquidity') rather than merely a narrowly defined stock of money.

Though, as stated above, there is no universally accepted monetary theory, monetary authorities in the West appear to have been impressed by the views outlined in (*A*) and to some extent by those in (*C*). This does not mean to say that the authorities have piecemeal accepted a specific theory in formulating their policies. They have, however, endeavoured to control money supply and interest rates in order, with the aid of other instruments of control (e.g. fiscal policy), to affect the level of employment, growth, price stability and the balance of payments. The Governor of the Bank of England recently stated:

> The conduct of monetary policy is never a simple matter. Our understanding of the links between the financial world on the one hand and the real world of output and spending on the other is far from perfect. There is a wide divergence of view about how effective monetary policy is in influencing spending and through what particular channels it should primarily aim to operate.[1]

Monetary control has thus been a method of controlling the level of aggregate demand – a macroeconomic tool of national economic management.

In contrast, monetary control in Soviet-type economies is primarily a microeconomic control – control by banks over the activity of individual firms. Each firm must bank with only one bank (usually a branch of the central bank), which settles its debts, in which cash reserves are kept, and which is the exclusive source of credit.

The importance of bank credit

An important element common to Western and socialist monetary control is the role played by bank credit. In the West control of money supply has become essentially the control of the total volume of bank deposits. This the authorities try to achieve by affecting the demand for bank credit (e.g. by acting on the rates of interest paid by borrowers), and/or by acting on the liquidity of commercial banks, and/or by imposition of direct restrictions on advances. Where (as in the UK) monetary control has been extended to other financial intermediaries, continuous monetary control (e.g. based on a fixed

[1] 'Monetary management in the U.K.', *BEQB*, vol. 11, no. 1 (1971) p. 37.

© in this web service Cambridge University Press www.cambridge.org

CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

minimum reserve ratio) tends to apply only to commercial banks; other financial institutions are intermittently 'requested' to adjust their lending. Thus, in spite of attempts to extend monetary control to other institutions, attention is still focused on banks.[1]

Two points may be stressed. First, currency issues, as opposed to issues of credit, are of secondary importance in peacetime monetary control both in the West and in socialist economies. They are quantitatively less important and frequently are governed by technical (e.g. seasonal) considerations. Furthermore in both types of economies the currency in circulation is a declining proportion of other financial claims. In short, currency is merely 'the small change' of the financial systems.

However, the illustration of this is not a straightforward matter. Table 1 gives some indicators, though these are by no means strictly comparable. In Western economies, especially, the definition of money supply is a major problem, which cannot be elaborated here. As stated earlier it is debatable whether some claims of the many have the unique characteristics of 'moneyness' and can therefore be indisputably classed as money supply. The table thus uses three officially published concepts of money supply in the UK, of which *M2* and *M3* would probably be closer to the 'money supply' used in the columns referring to Poland. Although *M3* is sometimes known as the 'broad definition' of money it does in fact omit liabilities of many financial institutions in the UK. If this definition were broadened to include some of these, namely building societies, trustee savings banks (special investment departments) and finance houses, then the ratio of currency to that total would be 10.8% for the end of 1969; the inclusion of insurance (life) companies would further lower this ratio to 7.4%.

Thus the salient feature of both Western and socialist monetary control is the attempt to achieve certain objectives by manipulating credit conditions.[2] Indeed, in socialist literature, the terms 'monetary policy' or 'monetary control' are used comparatively rarely, preference being given to the term 'credit control'.

[1] At the time of writing measures have been announced changing the techniques of monetary control in the UK. See *BEQB*, vol. 11, no. 2 (1971) pp. 189–94, 'Reserve Ratios and Special Deposits, *Bank of England*, Sept. 1971.

[2] It may be noted that the Canadian Royal Commission on Banking and Finance (reporting in 1964) in evaluating the efficacy of monetary policy specifically analysed the effect of 'credit conditions' on aggregate expenditure (see esp. ch. 24).

© in this web service Cambridge University Press www.cambridge.org

Cambridge
Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

Table 1

Currency in circulation in relation to other bank liabilities in the UK and Poland 1963–9

(*percentages based on data of balances outstanding at the end of the year*)

	UK			Poland	
	Currency with the public as % of[1]:			Currency with the public as % of 'money supply'[2]	Preceding column + cash balances in socialised enterprises as % of 'money supply'[2]
Year	*M1*(1)	*M2*(1)	*M3*(1)		
1963	31.7	21.4	19.9	13.8	14.4
1964	33.6	22.3	20.6	13.8	14.6
1965	34.9	22.6	20.6	13.4	14.1
1966	35.4	22.5	20.2	13.0	13.6
1967	34.4	21.8	19.1	12.3	13.0
1968	33.7	21.1	18.1	–	12.6
1969	35.5	22.0	18.5	–	11.2

Notes:

[1] *M1–M3* are series of money supply officially published in the UK. *M1* includes notes and coin + current deposit bank accounts of private sector residents denominated in sterling. *M2* is *M1* + sterling deposit accounts of private sector residents + deposits of discount houses. *M3* consists of notes and coin outside banks + all resident deposits with UK banking sector in sterling or foreign currency. For explanations see: A note on definitions of money supply, *Economic Trends* no. 202 (Aug. 1970) p. xi.

[2] Here measured as total balance sheet liabilities of the banking system. For more details see table B1b.

Sources: *Economic Trends*, p. xiv. GUS – *RSF 1945–1967*, p. 232; NBP – *Information Bulletin 1970*, p. 42.

Secondly, in a socialist economy banks, whose functions are strictly defined, comprise the whole system of financial institutions. In contrast, in a Western economy banks, whose legal status and definition in economic terms often present difficulties, are merely one of a number of financial intermediaries comprising the financial sector. In the UK at the end of 1969 the deposits of the UK deposit banks, which the monetary authorities have regarded as especially important for purposes of monetary control, were 75% of the deposits in the remainder of the 'banking sector' – national giro, accepting houses, overseas banks, discount markets[1] – and 48.1% of the assets

[1] *BEQB* vol. 11, no. 2 (1971) p. 242.

© in this web service Cambridge University Press www.cambridge.org

CAMBRIDGE

Cambridge University Press
978-0-521-13097-4 - Socialist Banking and Monetary Control: The Experience of Poland
T. M. Podolski
Excerpt
More information

held by some non-bank financial intermediaries: insurance (life) companies, building societies, trustee savings banks (special investments department) and finance houses.[1]

Bearing in mind the above differences, concentration on the control of the supply and cost of bank credit allows us to investigate the most essential aspect of monetary control and achieve some comparability between monetary control in the West and in socialist planning. In the West special attention is paid to bank credit because bank deposits are considered to be the larger part of money supply, because monetary authorities tended to lean towards theories proposing causation between money supply and other variables (e.g. national income level), because deposit banks are among the largest financial institutions and because they were thought to be able to 'create' credit (and hence to create money).[2] In soviet-type economies control of the supply and the cost of credit is considered to be the most appropriate form of bank control, though, as will be seen later, it is not the only form. Socialist banks also exercise forms of control (e.g. over wage funds of enterprises) which are completely alien to Western banking systems. One further difficulty occurs in a socialist system, namely the growing tendency to use credit for financing investment. The term monetary (or credit) control is reserved for control via the supply and/or cost of short-term credit, making it roughly comparable with the Western practice. Credit finance of investment in a socialist economy is really a counterpart of the Western finance of investment via various instruments customarily traded in stock exchanges. Thus bank finance (and control) of investment is treated separately from monetary control throughout the book.

To sum up, the controversial nature of money and monetary control and the specificity of Western and socialist monetary systems necessitate a loose definition of monetary control in terms of attempts to achieve certain objectives by using monetary means, in particular bank credit supply and/or interest rates. Whenever comparisons between Western and socialist economies are made it is necessary to

[1] Without insurance (life) companies the ratio is 100.1%, 'The Financial Institutions', *BEQB*, vol. 10, no. 4 (1970) p. 425; vol. 11, no. 1 (1971) pp. 54–64.

[2] It must be mentioned that, especially in the last decade in the UK, the rate of growth of deposit banks has been relatively slower than that of other financial intermediaries. Moreover, it is now believed that multiple credit creation is not a unique characteristic of deposit banks.

© in this web service Cambridge University Press www.cambridge.org