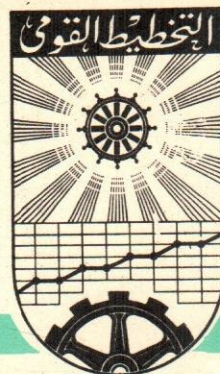


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Credit Planning
and State Supervision Function
of Banks in the GDR

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Introduction:-

The UAR is going ahead in its industrialization very speedily. The more planning and programming the more following-up is necessary. The problem can not be solved only by statistical reports or by the responsibility of the managers. It is in this context that the socialist banks have to play their role. New functions of ~~credit~~ and interest arise after having public ownership of enterprises and banks. All bank activities have to be linked with the targets of national plans. The bank should participate in enterprise planning, especially in financial planning. The financial flow discovers the achievements of every enterprise permanent. Therefore, banks are able to serve with a supervision function. In the socialist countries banks are considered as the centre of permanent supervision.

In order to explain under which preconditions such a system is workable the experiences of the German Democratic Republic in the last 15 years are concerned in this paper. I recommend to read my memorandum "The functions of banks in financing public enterprises" (INP. No. 743) first. Besides this it also should be read the memorandum "Concepts of investment financing with reference to the GDR Investment Bank and the UAR Investment Fund", published by M.A. Elhamy and E. Knauth. (INP. No. 747)

I. The banking system

There are the following banks:

The National Bank (Deutsche Notenbank) as the issue bank and the branch bank for all branches except agriculture and foreign trade. This bank is also ~~acting as~~ the state bank keeping all or accounts of state bodies and organizations.

The Investment Bank as the centre of following-up investments. This is not a fully developed bank, but, it is more a state supervision authority than a bank. The financial sources determined for investment have to be accumulated at special purposed accounts of the enterprises and general organizations opened at National Bank as the branch bank.

That means, depreciations, profit shares, ~~grantings~~ from the budget and also credits for investments have to be collected at this special investment accounts (Investment funds of enterprises and general organizations). It doesn't ~~matter~~ whether investment credits are spent from Investment Bank or National Bank.

The Investment Bank has to approve all withdrawels of financial means from this investment funds (accounts) accordingly with the carrying-out of the ~~stages~~ of investment projects. This approvals are in fact a system of unblocking of means based upon a supervision on the spot.¹⁾ It is expected to incorporate the Investment Bank into the National Bank as a special supervision department for investment financing and carrying-out. Nevertheless, that will not affect the supervision function in the field of investments. On the contrary, it may increase the efficiency of supervision, because the experiences in current and investment supervision can be used simultaneously.

1) Cp. Elhamy/Knauthe: Concepts of investment financing with reference to the GDR Investment Bank and the UAR Investment Fund, INP. Memo. No. 747.

The Agricultural Bank is the centre for financing of current operations and investments of cooperative and public farms.

The Foreign Trade Bank is responsible for financing the foreign trade companies and for international clearing as well as for credits in foreign currency.

The local cooperative banks are responsible for private and cooperative handicrafts, private retailers and innkeepers (current accounts, credits).

The local saving banks are responsible for private savings and consumer credits as well as for financing of public housing.

It is impossible to open a private account at National Bank, Investment Bank, Agricultural Bank, and Foreign Trade Bank. All private accounts are to be opened at the local saving banks. Naturally, everyone is allowed to open so much saving accounts as he likes. Also salaries are to be transferred to accounts opened at saving banks as far as payment by cash is not desired by the employee. A special kind of saving banks is the post saving bank. But, despite that, the post office is the general agent of all other saving banks, too. Therefore it will accept payments and withdrawals on account of every other saving bank. In this case the post will book the payment or withdrawal in the submitted saving book, cash or pay and inform the relevant saving bank.

All these banks are public banks (with the exception of the local cooperative banks which are working under state control). Public banks are an essential precondition for having a planned national economy. There are at least two functions of banks in a planned national economy.

First : The distribution function. The banks are collecting deposits which represent preliminary free means of the national reproduction process, and, these means are preliminarily distributed with the help of credits;

Second: The state supervision function. The banks concentrate and canalize the ~~money~~ circulation and, especially the financial flow in such a way that a comprehensive following-up of the reproduction process of every public enterprise and branch is ensured.

There are also other bank functions like organizing the money circulation, keeping stability of national currency and organizing national and international clearing systems as well.

II. Essential points regarding money circulation and clearing

In order to link banking system with a planned national economy it is necessary to organize and canalize money circulation and financial flow. Under this precondition banking system can be used for following-up the fulfillment of national economic plans. In a socialist economy banking system is considered as the centre of operative and permanent supervision of economic processes. It is in this context that socialist banks are acting in a state supervision function. But banks can not play this role by public ownership of banks only. In order to use the money circulation and the financial flow as a signal it is necessary to organize and canalize them.

Good preconditions for organization and canalization of money and financial flow in the UAR are given by public banks and their specialization on branches. But, it is necessary to have more special regulations in order to link the banking system completely with the requirements of planning and following-up in public sector. The GDR started in the early 50's some measures aimed at better money circulation and financial flow.

Every enterprise is allowed to be connected with one bank only.

Thus the bank is in the position to be permanently linked with the same enterprises and to accumulate experiences in financing and supervision with reference to certain

branches. Since in the GDR do not exist different branch banks for industries there are departments for every branch.

More specially speaking the following system or scheme of organization is applied: Every public enterprise is in touch with the local bank department which is keeping the accounts. But on the spot of the general organization responsible for a branch (or group of articles) there is established a branch department of the bank (National Bank). This department is responsible for credit planning regarded to the enterprises in the branch and for analysis and supervision of observance of the targets. The branch department is without cash operations. On the basis of the approved credit plan every enterprise is allowed to fix credit agreements with its local bank department.

Obligation for keeping bank accounts preventing cash operations between enterprises.

All enterprises are obliged to have business accounts at their banks. Deliveries and services must be paid by transfers and are not allowed to be paid in cash. Salaries and wages are paid in cash or transferred to private accounts opened at the saving banks. Payment and transfer of salaries and wages must be in accordance with the annual plan and its fulfillment. This is to check on by the bank. Every enterprise has only a small cash for its purposes the amount of it is limited by the bank. Exceeding cash money is to be paid to the bank daily. Retailers, innkeepers, gardeners, handicrafts and companies with all kinds of services must

pay in their turnover proceeds daily as far as the cash limit laid down by the bank is exceeded. All this is stated by a public law concerning the cash money circulation. As a matter of fact the result are two spheres of money circulation: The money transfer system and the cash money circulation.

As to the cash money circulation it is limited on privat consumption. Therefore, the amount of circulating money is a function of the cover or supply of commodities and services since savings in cash are not usual by the GDR population. . On the other hand the daily paying-in of turnover proceeds in cash at bank accounts is an exact mirror of fulfillment of the retail sale in every region. By reason of these measures the speed of money circulation is relatively high.

Obligation of payment for deliveries and services in a short run resp. application of a compulsory clearing system.

In order to prevent commercial credits between enterprises payments for deliveries and purchases have to take place as soon as possible. With a public law concerning regulations of clearing systems this problem is solved. In principle we can distinguish between two kinds of clearing (terms of payment):

First: The enterprise is obliged to pay immediately after reception of the goods. In this case there is a commercial credit granted by the supplier. The time for such credits should be strongly limited. In the GDR it runs normally to 10 days; in some exceptions to 30 days.

Second: The bank of the enterprise, which is the supplier, is managing a clearing with the bank of the customer immediately after getting a copy of the bill. The supplier will get his proceeds from his bank immediately. In this case the commercial credit is limited on 1 to 3 days necessary for giving the bill to the bank and for getting the credit note. This system is usually applied for deliveries of mass products.

Separation between current accounts and funds for accumulation.

Every enterprise is obliged to transfer taxes and profit shares to the general organization resp. to the budget monthly. Very great enterprises are obliged to transfer the turnover taxes every fifth day. As far as profit shares are determined for investments in the same enterprise, for bonus to be spent to the workers and for reserves, a monthly separation of means must be ensured.

In fact there are no remarkable reserves in GDR public enterprises because reserves are to be formed at central level and by the general organizations. For investments and bonus fund special purposed accounts must be opened. The depreciations must also be separated monthly. Usually they are to use for investments and consequently, to transfer to the enterprise investment account which is under the supervision of the Investment Bank. As far as depreciations are not to be used for investments in the enterprise they have to be transferred to the general organization monthly.

To sum up: In order to ensure a highly effective supervision by banks the cash money circulation and the terms of payment (clearing system) must be organized and canalized. The main items in this field are in the GDR:

- a) Every enterprise is connected with only one bank;
- b) All payments except wages must be transacted by money transfer,
- c) Proceeds in cash are to be paid in daily as far as the cash limit set up by the bank is exceeded;
- d) The time for payments is limited accordingly to the terms of payment issued by government. In fact the time is so short that commercial credits are prevented by a bank clearing system resp. the time for payment is strongly limited by law;
- e) Every public enterprise has to separate or to transfer the profit the taxes and the depreciations monthly at least.

Under these preconditions the bank is in the position to follow up money circulation and sale. The deviations of sale between targets and effective sale will be discovered in this way.

III. Essential points regarding capital allocation of working capital (limitation of stocks)

Working capital of public enterprises should be limited accordingly with the targets of output. The main items of working capital are : raw material, unfinished goods, finished goods, and money funds (current accounts including active debts). The financial cover of working capital can be own working capital, current debts and credits granted by the bank. Since a clearing system is applied, current debts are strongly limited and, consequently, own working capital and bank credit remain as the two main sources for working capital in enterprises. The limitation of working capital is on first place a matter of physical (material) limitation of stocks (raw material, unfinished and finished goods) and not so much a matter of financial sources.

The physical stocks of working capital depend on the extent of output, the time of production and sale, and the development of cost which determine the value of stocks.

Consequently, the necessary working capital is determined by the development of output and cost lowering as well as by the shortening of time for production and sale. On the contrary : Every deviation from a normal production flow will result in higher stocks of working capital in case of higher cost and longer time for production and sale. An over-fulfillment of output targets will result in higher stocks of necessary working capital. An under-fulfillment of output targets may lead to a reduction of working capital, but, it may also result in higher stocks if it is connected with higher cost and longer time for production and sale.

All deviations should be analysed. In order to be able to do it an annual planning of working capital is necessary in every enterprise. The normal stocks of working capital should be determined accordingly to output; cost and time for production and sale. The annual enterprise plan of every company includes a so called standard plan for working capital in the GDR economy. The normal amount of working capital and the financial cover are fixed in this plan. It is to approve by the general organizations. The bank is taking part in elaboration of this plan, and it gets a copy after approval. Thus, the basis for normal financing and credit-agreements is available.

Since all other financial sources are eliminated by the help of a system of organization and canalization of money flow as introduced in the preceding paragraph the stocks of working capital can be covered only by financial sources approved in the standard plan.¹

For instance: the standard plan limits the working capital to 100 and the own working capital to 30. The difference of 70 is the credit limit. The planned own working capital fund is to form by comparing the effective own working capital with the new standard. Let us say the effective own working capital is 25, the enterprise in question will get additional 5 units from the general organization or is allowed to use profit for

1. As to the methods suitable for calculation of the necessary working capital for an enterprise, please, compare my memorandum: "The functions of banks in financing public enterprises", INP. No. 743.

these purposes. The credit (70) is a credit limit. In the frame work of this limit the bank will grant credits under normal conditions. Naturally, the bank will not grant these credits automatically. But, the limit outlines the normal process of production and sale.

In case of deviations the enterprise will need more credit. Since all other financial sources are canalized the only solution is to get credits for overstocks. The bank is allowed to grant additional credits under two preconditions:

- much higher interest rate (i.e. 8, 10, 12 % instead of 2, 2.5 or 3 %)
- the enterprise must submit a rationalization programme.

Examples :

1. The enterprise has too much stocks of raw material caused by an uncorrect organization of stock piling. The rationalization programme should mainly be concerned with improvements in the inventory control system.
2. The enterprise has stocks of finished goods higher than planned, because marketing research was not up to date. The rationalization programme should include measures aimed to change assortment, quality and fashioning of the products.
3. The enterprise has too much stocks of unfinished products, because the final products can not be completed. The suppliers didn't observe the contracts concerning fittings and accessories with respect to assortment, deadlines and quality. The rationalization programme should be aimed to improve the cooperation and production flow in the enterprise and in the premises of its suppliers as well.