The Economic Causes and Consequences of the First World War

EDITORS:
Ivan Vujačić
Mihail Arandarenko

Centar za izdavačku delatnost
EKONOMSKI FAKULTET U BEOGRADU

Publisher
Publishing Center
Faculty of Economics, University of Belgrade
Kamenička 6, tel. 3021-045, faks 3021-065
E mail: cid@ekof.bg.ac.rs

Dean of the Faculty of Economics
Prof. Branislav Boričić, PhD

Director of the Publishing Centre
Đorđe Mitrović, PhD

Designed and formatted by
ČUGURA PRINT, Beograd

Printed by
ČUGURA PRINT, Beograd
www.cugura.rs

Year
2015

Reviewers
Milica Uvalić
Slobodan G. Marković
Božidar Cerović

Circulation
300

ISBN: 978-86-403-1451-0

Publishing and printing supported by the Ministry of Education, Science and Technological Development of the Republic of Serbia

Contents

Chapter 1

The Economic Causes and Consequences of the First World War: Introduction and Overview

Ivan Vujačić*
E-mail: ivujacic@ekof.bg.ac.rs

Mihail Arandarenko**
E-mail: arandarenko@ekof.bg.ac.rs

The period preceding the First World War was one of the first modern globalization. Never before had the world economy been so intertwined. Indeed the sudden end of this prosperous world came as a shock to its contemporaries. Why did it happen? What were the geopolitical economic ideas that shaped the world and specifically the region of Southeastern Europe before the war? Historians differ as to the weight of the factors that influenced the major actors to adopt a specific pattern of behaviour that led to this historical event.The Great War has not only destroyed the empires and created a new geopolitical and economic environment, but has also profoundly reshaped economic theory and policy.

The papers in this volume were solicited by the Faculty of Economics, University of Beograd, in order to highlight the key economic issues related to the period on both sides of the great divide created by the First World War. The authors were then invited to discuss these at a conference held on September 19th and 20th 2014, at the Faculty of Economics, University of Beograd[1]. The papers aim to analyze the economic causes of the First World War and give an overview of the economic developmentsup to the onset of the Great Depression, as well as to shed light on the role and impact of economic ideas and ideologies of the time. The volume hopes to bring attention to the heavy and disastrous impact on the economies and societies

* Institution/Affiliation: The Faculty of Economics, University of Belgrade. Research for this paper was supported by the Ministry of Science and Technological Development of the Republic of Serbia through project no.179065.

** Institution/Affiliation: The Faculty of Economics, University of Belgrade.Research for this paper was supported by the Ministry of Science and Technological Development of the Republic of Serbia through project no.179065.

1 The papers were refereed by anonymous referees and some have undergone changes. Not all papers are published here as some have opted for other publications while some have been rejected.

of the region, and the way they embarked on the post-war reconstruction within a profoundly changed world.It is our belief that the papers in this volume testify that these issues were adequately considered and that they represent a contribution to the deeper understanding of the economic history and history of economic ideas before and after this cataclysm whose centenary inspired its publication.

The opening paper by Lampe gives a comprehensive and insightful overview of the consequences of the war for the countries of Southeastern Europe. A much neglected economic cause of World War I according to Lampe is the failure of Austro-Hungary to ensure dominance of the Serbian economy. This led to a bellicose attitude and a militarization of diplomacy which ended in the outbreak of war. The consequences for the countries of the region were not just in terms of destroyed property and loss of lives, but the disruption of trade and the transfer of populations. The post-war recovery was not strongly supported by the victors. After tracking the brief, limited assistance provided, the paper reviews the massive economic problems confronting four of the five of independent states, neglecting Albania as a special case. The Bank of England made an effort to prevent inflationary pressures by putting currencies back on the gold standard with the Pound Sterling as a reserve currency. This only helped the reduction of war debt. However, the overvalued exchange rates restricted credits and did not encourage investment. A further consequence was that these monetary regimes did not attract foreign capital and stimulated protectionism. Lampe argues that the European Union had learned the lessons in the post-Cold War period by promoting common fiscal practice, the reduction of trade barriers and by offering prospects of integration and membership. The post-crisis period after the recession of 2008 have with the overvalued euro brought back problems to the region that is reminiscent of the post World War I situation.

The paper by Vujačić gives a broad overview of both the political, social and economic factors that led to the first modern globalization. This brings us to the economic theories of imperialism, dominantly Marxist in origin that directly linked this first modern globalization to imperialism. The paper highlights the major features of the world economy as well as the major features of the theories of imperialism of the time. The discussion proceeds by giving an overview of the main characteristics of the present world economy and the analogies between these and the major features of the world economy that preceded the First World War. It also discusses the evolution of neo-Marxist theories of imperialism that aim to interpret the newest wave of globalization. This broad overview concludes that although many similarities between the two globalizations are evident, analogies also point out major differences.

Imperialism as an explanation of the causes of the First World War was not confined to economic and Marxist theories of imperialism. None other than Joseph Schumpeter tried to explain imperialism as a remnant of the past that had destroyed the first modern globalization. His work was a major effort in delinking the outbreak of the war from the inner logic of capitalism as Marxist theories had contended. The paper by Josifidis and Lošonc addresses Schumpter's theory of imperialism and tries to put it into a broader perspective. Their paper elaborates on the pre-capitalist elements in Schumpeter's theory of imperialism and draws parallels with the analysis of some Marxist thinkers like Kautsky. According to the authors, Schumpeter's analysis was also fundamentally influenced by Hilferding, a Marxist theoretician on imperialism. This makes Schumpeter's theory both complex and multi–layered. Nevertheless, the authors reject the divorce of imperialism from economics at the same time rejecting mechanical Marxist causality. They embrace the methodological standpoint of Hicks's simultaneous causality and elaborate on Schumpeter's conclusions while advancing their own viewpoint.

Imperialism and foreign direct investment were interrelated in a complex way in the first globalization as depicted in the paper by Vujačić. The paper by Stojadinović and Jakšić elaborates this aspect of foreign direct investment more deeply and links it to the rise of international business. The paper reproduces useful data on the level, concentration and dynamics of foreign direct investment. Before the First World War, and business operations were heavily concentrated in the exploitation of natural resources. After the First World War the focus shifted to manufacturing. Most foreign direct investment originated in a small number of developed countries, but it was widely dispersed, mostly to developing economies. After the First World War, in the 1920s, there was a modest recovery in international investment and business, but the circumstances had changed. The return to the gold standard was slow and there was more protectionism which culminated after the Great Depression.

Turning to other consequences of the First World War, it is necessary to see the vast changes that occurred in the perception of the desirable characteristics of the world economy. The paper by Praščević tries to address the broadest issue of *laissez faire* versus protectionism. While there were exceptions to the free trade philosophy of the pre- First World War era, it was still dominant. Praščević argues that after the war European economies abandoned the *laissez-faire* system and free trade and turned to state intervention, a regulated market system, economic nationalism, and protectionism. A particularly important feature of the free-trade system was the gold standard which took a long time to be re-established after the end of the First World War. It became a modified gold standard and created unemployment in countries that returned to a parity that was high (Britain). The end of laissez-*faire* also came with the introduction of communism as a different economic system and totalitarian statist regimes that came into being in the 1920's and 1930's following the Great Depression. This also, led to a major shift in economic theory thanks to the birth of macroeconomics which can be attributed to John Maynard Keynes.

That the First World War led to the dissolution of monetary regimes and exhibited vast differences in this respect with the pre-1914 period is elaborated in the paper by Jakšić. He contends that the change from non-inflationary to inflationary long–term development can be explained by a change in the monetary regime between 1914 and 1930. This is supported by two arguments: a) all hyperinflations that occurred after 1914 occurred under discretionary paper money standards, and wars were not their primary cause and b)all countries that switched from the gold to the paper standard during the 18th and 19th centuries have recorded higher inflation rates. Jakšić concludes that the necessary and sufficient conditions for monetary stability are a metallic standard, an independent central bank, and fixed exchange rate. This type of monetary regime shows a far smaller tendency towards inflation. He goes on to illustrate some of the hyperinflations that have occurred after the First World War and since, most notably the German hyperinflation of the 1920's.

The vast change in the world financial system is also the subject of the paper by Šoškić, who gives an overview of the global monetary policy challenges after the First World War. He points out that the system of the gold standard had serious embedded flaws. Volatility of inflation and output were higher in the short run. The supply of money was determined not by the rates of economic growth but by the amount of available gold and could not be adjusted in response to economic needs. New sources of gold would increase money supply and inflation and decrease interest rates; the opposite of what modern central banks would do to provide stable economic growth. In spite of this the gold standard was seen as the lynchpin of the world financial and trading system. Šoškić continues with an analysis of the impossibility of reestablishing and maintaining the gold standard after the First World War. Torn between the need of competitiveness and credibility choices of par with gold led to different outcomes. The Great Depression showed it to be unsustainable.

Leaving monetary issues aside, the First World War created a dark intellectual mood in Europe due to the vast destruction that had been its result. One of the rare voices of optimism was that none other than John Maynard Keynes who had made his name as a public intellectual through gloomy forecasts of the consequences of the Versailles Treaty in his much celebrated *Economic Consequences of the Peace*. In it he predicted the German inflation, the rise of populist nationalist politics of resentment due to the harsh measures imposed on Germany in terms of war reparations.

However, in a playful essay written on the eve of the Great Depression Keynes wrote on "The Economic Possibilities of our Grandchildren". In it he predicted that a hundred years hence (2030), the struggle of humankind to secure the necessities of life - in advanced ('progressive') countries would be solved. He also made the prophecy that there would be a 15-18 hour working week, to make room for more enlightened leisure. The paper by Arandarenko sheds light on the reflections of prominent modern economists on the accuracy of the predictions put forth in this essay. Almost all agree that his prediction on GDP growth per capita was remarkably accurate given that it was made at the time when economic growth theory did not even exist. The majority finds that the prediction on leisure is off the mark butthat variations between world regions due to income level exist, making the European variety of capitalism more in line with Keynes's predictions than is the case with the United States. Arandarenko looks at some of the other criticisms of Keynes's predictions and the related issues that have been brought into the discussion of this essay- income inequality within countries and between nation states, trends in working hours, world poverty and ever growing needs (consumerism) and the like. Broadening the perspective further, Arandarenko constructs and defends a revised version of Keynes' prophecy and concludes that "in accordance with Keynes`s optimistic prediction, the great escape from poverty, hunger, disease, and burdensome work is well underway".

This brings us to the second group of papers dealing with regional and country specific issues and comparisons. In this group there are also papers shedding light at evolving forms of business organization, entrepreneurship and accounting in historical perspective.

The paper by Bartlett provides a comprehensive overview of the cooperative movement that developed in many European countries before, during and after the First World War as a form of countervailing power to the prevailing capitalist economic system. Historically, cooperatives were first organised by small farmers to defend supply prices through marketing cooperatives and credit unions. As a form, they also spread among the growing urban populations in the form of consumer cooperatives to ensure a supply of quality goods at affordable prices and to a lesser extent through workers' production cooperatives. By 1914, cooperatives had emerged as a significant economic force in the Austro-Hungary, Russia, Italy, Germany, France and the United Kingdom. During the war, cooperatives provided a defense against poverty, and filled the gap in supply created by the inability of the private sector to supply basic commodities as part of the war economy. Following the end of the war, cooperatives enjoyed a further development throughout the 1920s playing a significant role in post-war reconstruction. Associations of cooperatives became powerful economic actors and even began to develop as a political force. Bartlett points at the important and somewhat forgotten study of the Russian economist A. Chayanov who in 1927 produced a significant theoretical analysis of the cooperative economy that countered the prevalent views of both soviet and pro-capitalist economists. However, with the onset of authoritarian rule in the 1930s, the cooperative movement lost ground. In Soviet Russia, collectivization of agriculture destroyed the peasant cooperatives, in Italy the cooperatives were suppressed by the Fascist state and in Germany and Austria by the Nazis. As a “third way” between the inequalities of capitalism and the overbearing central control of the state under Stalinism and Nazism the cooperatives had demonstrated their economic viability and resilience in the face of economic crises and the ups and downs of the business cycle. However the economic crisis of 1929 has brought about the near demise of the classical cooperative movement, with only Italy and France retaining significant cooperative movements.

Returning to the region, Jovanović Gavrilović, Rikalović and Molnar analyse the economic development of Serbia after World War I when it became a part of a larger state, the Kingdom of Serbs, Croats, and Slovenes, which covered areas with different historical backgrounds and different economic development. This economic diversity was reflected in relatively developed market economies in Slovenia, Vojvodina, and parts of Croatia and a subsistence economy in certain areas of Serbia, Bosnia and Herzegovina, Macedonia, and Montenegro. The wider market, an abundant work force, diverse natural resources, and a favourable geographic position could have boosted economic development in Serbia. However, the authors claim that Serbia’s inherited problems, combined with the character of the established economic system, were unfavourable to formulating a strategy of general and regional development, and thus a more significant change in its economic position and structure. Despite certain results in economic development in the period 1919-1929, Serbia remained economically underdeveloped compared to Western European countries. The main aggravating factors that prevented progress were a lack of capital and skilled manpower, low level of technical equipment, dominance of small industrial production, general backwardness of agriculture, and significant reliance on foreign capital, which was largely speculative. In addition, Serbia was a peasant culture, with a high level of illiteracy. The economic crisis that gripped the world in 1929 eventually transferred to Serbia. Development problems in the Serbian economy that became evident after the transient post-war conjuncture come to the fore in these new conditions.

Jagodić and Radonjić look at the disastrous effects of World War I on Serbia, which, although ended up on the winning side was one of the most ravaged battlefields of the war. Their paperfocuses on Serbia’s demographic losses and the impact of the war on Serbia’s agriculture, industry, and state finances. It is based on official statistical data and the relevant literature.Serbia’s estimated demographic loss amounted to a quarter of its pre-war population. However, Jagodić and Radonjić rightly point out at the important and sometimes neglected distinction between demographic and population losses. In popular view, but also according to some authors and partially by contemporary official sources, demographic (counterfactual) losses have been presented as direct population losses. Nevertheless, loss of population caused adverse and long lasting deformations in the demographic structure, so that the most important part of the labour force (males from 15 to 54 years of age) constituted less than a quarter of Serbia’s population in the post-war period.

Furthermore, a significant portion of the overall population became partly or completely incapable of work. Considerable demographic loss, livestock diminishment, a huge decrease in agricultural tools, devices, and machines plundered or ruined during occupation, and the decline of cultivation immediately after the war left Serbian agriculture in shambles while hunger and poverty ruled throughout the countryside. The underdeveloped industry also suffered great losses. In the end, in order to finance the war, the Serbian authorities chose not to use inflation and opted for increasing its external debt to the allied countries. However, as soon as Germany defaulted on its war reparation obligations in 1931, Serbia also stopped servicing its external debts accumulated during the war.

The paper by Andreev provides a panoramic and informative overview of Bulgaria's economic developments before and after the war. Before the First World War Bulgaria was an agricultural country growing extensive crops and trying to export them to international markets. The wars for the unification of Bulgaria at the beginning of the 20th century had severe consequences for its economy and changed its territory, which also restructured its agriculture. The high price of tobacco during the First World War made it the preferred crop of Bulgarian farmers and despite the loss of territories suitable for its cultivation it remained the leading Bulgarian agricultural product and export after the war as well. The mobilization of the working population and the loss of people, livestock, and farm equipment decreased the productivity of Bulgarian agriculture, and at the end of the First World War even flour had to be imported to feed the population. Bulgarian industry prior to the war was underdeveloped and lacking capital; production capacity was small and profitability was low. The First World War destroyed the small factories that could not adapt to military production, while the existence of the rest was only possible with the assistance of the state, which supplied the required raw materials and realized their production. The peace treaties and the war reparations slowed down industrialization and Bulgaria remained an agricultural country with most of its population employed in agriculture. Andreev argues that the imposed reparations on Bulgaria hampered its economic recovery and contributed to the high post-war inflation. Reparations reduced the solvency of the country after the First World War (1914-1918), causing a deficit in the balance of payments. The structure of the Bulgarian economy was such that much of the national income was in kind, as the only monetary income was used to meet the financial needs of the state and for the payment of public loans and reparations. However, Bulgaria continued to pay the reparations until their termination during the Great Depression.

Kovačević sheds light at the customs war between Serbia and Austria-Hungary which lasted between 1906 and 1911 and which can be seen as a prelude to the real war erupting in 1914. The 19th century trade agreements between Austria-Hungary and Serbia protected the former's industrial exports from competition in the Serbian market and were successful in making Serbia export mostly raw materials and import refined products. In an effort to provide more favourable conditions for foreign trade, Serbia signed an agreement with Bulgaria in 1905 that abolished customs and other duties in mutual trade. Austria-Hungary immediately asked Serbia to provide the same conditions for its products, or to withdraw from the customs union with Bulgaria. Although the Serbian government demonstrated a willingness to revise the terms of the agreement with Bulgaria, Austria-Hungary was not satisfied and at the end of June 1906 banned the import and transport of livestock and all cereals through its territory. This led to a drop in Serbian exports of almost 80%. Although Austria-Hungary wanted to prevent the connection of the Balkan states, Serbia started a regional reorientation of its exports. During the customs war Serbian exporters found new routes to new markets, the quality of export products improved, and export structure substantially changed. The process of geographic redirection of trade was accompanied by penetration of the Serbian market by German commercial and French financial capital, and suppression of Austro-Hungarian commercial capital. Eventually, in 1911 Serbia concluded a new trade agreement with Austria-Hungary, after which only 18% of Serbia's total exports went to Austria-Hungary, and only 19% of its total imports came from Austria-Hungary.

The paper by Rafailović isa comparative study of the impact of WWI on the foreign trade of Yugoslavia (the Kingdom of SCS) and Bulgaria in the period from the end of the war to the Great Depression (1919-1929), through an analysis of the export and import of textiles. In both countries, a similar dynamics of a decline in imported final textile (wool and cotton) products and an increase in imported raw materials can be detected. While some authors believe that this is a clear indicator of the country becoming industrialized, others take the opposite view. According to Rafailović, this shift has more to do with the policymakers' attempts to maintain a positive foreign currency balance than with the industrial development strategy. A change in imports from the more expensive final products to cheaper raw materials contributed to decreased import value, and therefore to maintaining the balance. This structural change was not the result of successful domestic production but of other factors, which were the result of the First World War. Thus, according to Rafailović, the changes in foreign trade structure that resulted from World War One were the combination of the impact of the war on increased demand for textile goods in both countries and of the policies aiming to improve foreign currency balance, without fundamentally modernizing textile industry in Yugoslavia and Bulgaria.

Before the First World War, the gold standard was a must not only for credibility but also for sovereignty. The paper by Fabris elaborates the history of the efforts of Montenegro to obtain an independent currency (the perper) in the 1906 – 1918 period. This involved diplomacy with Austro- Hungary i.e. the signing of a monetary convention and the taking out of its money out of circulation after the introduction of the perper. The law on State Money implemented in 1911 had positive effects: it removed from circulation the Austrian silver and small nickel and copper coins, had a positive financial effect on the state treasury, and provided a domestic currency that had the full confidence of Montenegrins, reduced dependence on Austria-Hungary, and strengthened political independence. However, foreign outflows and hoarding resulted in a permanent decline in Montenegrin gold coins. Due to the state of public finances and the Balkan Wars, the first treasury notes were issued, but the whole episode of introducing an independent currency ended in the First World War and the occupation of Montenegro by Austro-Hungary in 1916. After the end of the war, Montenegro became a part of the Kingdom of Serbs, Croats, and Slovenes in which the dinar became the sole currency.

Todorović and Vučković analyze a specific aspect of Serbian economic modernization using an example of the development of auditing practice in the period around the First World War and are able to find interesting parallels with modern times. At the beginning of the 20th century and during the period around WWI auditing was poorly developed, which led to repeated financial and corporate scandals. When auditors are unable to satisfy requirements this leads to disappointment and results in an expectation gap. In an effort to narrow the gap, over time auditors have changed both audit practice and objectives. Todorović and Vučković discuss general guidelines for narrowing the current expectation gap and provide recommendations for future practice in Serbia. Auditors must take responsibility, learn from past mistakes, and face the fact that failure to recognize changing demands and external events will do serious and perhaps irreparable damage to their profession.

Lončar and Budić examine the role of Djordje (George) Weifert's entrepreneurial institutional work in the formation of the first Serbian cooperative financial institution during the early years of Serbian industrialization. They also examine institutional work for the maintenance of this institution during the time period before and after World War I. Examining the long-term resilience of this institution is relevant because it was not formed top-down by the government, as was the first Serbian Central Bank, but rather collectively by individual socially conscious entrepreneurs. These commercial entrepreneurs collaborated as social entrepreneurs by exhibiting stewardship behaviors in their commitment to create a financial cooperative as an institution that would serve the common good in Serbia. Going beyond their individual interests as commercial entrepreneurs, this group of entrepreneurs, led by Djordje Weifert, a pioneer in the Serbian brewing industry, formed the first Serbian financial cooperative aimed at preventing the growth of loan-sharking, which was spreading during the early years of Serbian independence and stifling the potential for long-term growth of the Serbian economy. Lončar and Budić conclude that the main motivator of Weifert as a commercial entrepreneur was his desire to act as a steward and create new institutions though social entrepreneurship.

In conclusion, let us say that the papers in this volume have attempted to highlight various economic aspects related to the First World War. We hope that the wide scope of the themes of these papers will appeal to a wide audience of scholars, as well as to non-academics. The consequences of the First World War are still with us in many ways and reverberate a century later. The centenary presented a good opportunity to reflect and inspire further reflection on both its causes and consequences. With this thought we invite the readers to explore this volume and to hopefully find a part of the answers that they may be seeking regarding this broad subject. We also hope that they may find new questions and inspiration to pursue these topics further.

Part I

Chapter 2

Stabilizing Southeastern Europe, Financial Legacies and European Lessons from the First World War

John R. Lampe*
jrlampe@und.edu

Abstract: This paper pays brief attention, although more than the recent flood of 1914 centenary books, to economic causes of the First World War before turning to it fateful economic consequences for Southeastern Europe. The Austrian lack of economic leverage over Serbia is cited as a reason for its resort to the military option. At the war's end, the option of the victorious powers to provide significant economic relief to the region where the conflict had begun was not taken. After tracking the brief, limited assistance provided, the paper reviews to the massive economic problems confronting four of the five of independent states, neglecting Albania as a special case, that could now be called Southeastern Europe. First Greece and then Bulgaria faced forced inflow of refugees. Romania and the Yugoslav Kingdom faced the economic integration of large new, formerly Austro-Hungarian lands. All of them were left not only with war deaths and destruction but also with large war debts, or in Bulgaria's case, reparations. The paper concentrates on the primary Western response to these four economies, an effort led by the Bank of England to replace immediate postwar inflation with the deflation needed to reestablish currencies with prewar convertibility to gold, now with Pound Sterling added to a gold reserve standard. Independent central banks, the major positive legacy of this initiative, were to lead the way. But the financial stability that all four economies did eventually achieve in the 1920s served only to reduce their war debts. Otherwise, maintaining the fixed and overvalued exchange rates restricted domestic credit, encouraged protective tariffs, and did not attract the foreign capital, especially new state loans, that this emphasis on a single, European financial framework had promised. A concluding section considers the lessons learned from a postwar period that promoted economic disintegration by the 1930s. Looking at the period since the end of the Cold War and then the wars of Yugoslavia's dissolution, we see EU leadership in the reduction of trade barriers, the promotion of common fiscal practice and the prospect of genuine European integration as Western lessons learned. Within the region, independent central banks have helped the process. But the stabilization of currencies around the overvalued Euro has posed a familiar post-1918 problem since the European downturn of 2008.

Key Words: financial stabilization, refugees, war debts, reparations, national currencies, gold reserve standard, central banks, Bank of England, foreign trade and foreign investment, capital markets

* Department of History, University of Maryland, College Park, MD, USA

The 1914 centenary has generated a flurry of Western publication on the war's short-term diplomatic and military origins, emphasizing contingent reactions and underlying political mentalities. But the longer-term causes and consequences have received little attention. This is particularly true for the framework of economic leverage and rivalry whose relevance to German war aims during the conflict itself were revived by Fritz Fischer in the 1960s. To be sure, the initial attraction of the Fischer thesis, extending those aims back before the war and making a case for German war guilt after all, has receded in subsequent Anglo-American and German scholarship. Declaring war primarily to stifle domestic opposition from Germany's rising Socialist Party has not stood up to widespread criticism. At the same time, however, this criticism has helped to turn attention away from any consideration of economic causes for the start of the war. Now the current attention to 1914 leaves the war's fateful economic consequences unattended. They are too often confined within critiques of the Paris Peace Conference. Its set of bad new borders and unjust treaties lead us right to the Second World War, according to this simplified scenario. The bloody dissolution of Yugoslavia in the 1990s has encouraged this retrospective narrative, making the creation of a Yugoslav state in the first place a prime example of the misdeeds of the victorious powers in 1919.[1]

The question of the war's economic causes deserves at least some brief attention before this paper turns to the clearly momentous economic consequences for Southeastern Europe. This seems justified because the three major Western studies in the flood of new1914 studies that have appeared in 2014 pay no attention whatsoever to the economic background to the war. The contingencies of 1914 are seen as decisive. Margaret Macmillan concentrates on them with special attention to diplomatic disjunctures and political mentalities. Max Hastings draws on his background as a major military historian, to focus on competing plans for mobilization and warfare. At least in his Introduction, he credits a nuanced version of the Fischer thesis for being right about German military preparations from 1912 forward.[2] Christopher Clark justifies the contingent diplomatic reactions of Germany and Austria-Hungary to the Sarajevo assassination of the Archduke, for which he finds the Serbian government directly responsible and unwilling to respond satisfactorily to the subsequent Austrian ultimatum. Clark's retrospective inclination may be seen in his Introduction's reference to the Srebrnica massacre in 1995 as continuing a pattern of Serbian misbehavior, while his substantive argument on the war's origins has been criticized for what a Bibliographic Essay in *The Cambridge History of the First World War* has called "a bias against Serbia and towards

1 Macmillan (2007) is the most widely cited example of this verdict.

2 Hastings (2014), P xx; Macmillan (2013). For an insightful review of the mass of prior scholarship from Sidney B. Fay forward, see Martel (2014), Pp 401-31.

Austria-Hungary and Germany, whose decision makers vanish from the narrative at decisive moments in 1914".[3]

The economic case against the two Central Powers has long been neglected, in part because of Anglo-German trade relations, each being the other's best customer. Also, German trade with Serbia undermined the Austro-Hungarian tariff war with Serbia, 1906-11. So the old notion of a coordinated Austro-German trade offensive focusing on the Balkans is not persuasive, even after the several loans to a presumably anti-Serbian Bulgaria after the Balkans Wars. But two financial features offer support to the argument that the disposition to acting on military plans in both Berlin and Vienna from 1912 forward was too clear to call either of them "Sleepwalkers" in 1914. For Germany, calculations by my Maryland colleague Jon Sumida from the seminal work of David Herrmann on pre-1914 armaments reveal that military spending from the German budget doubled from 1911 to 1913 and the expenditure per soldier rose by 60 percent, far ahead of any other Great Power.[4] Here was the advantage in heavy artillery, machine guns and training that made the Schlieffen plan seem realistic against the increased numbers of French troops. For Austria-Hungary, on the other hand, it was the lack of any financial leverage over its Serbian adversary that made the military option seem the only recourse despite its lagging arms expenditure. From Vienna's failure to obtain a controlling interest in the Serbian national Bank in 1883 forward through the ascendancy of French banks and state loans from 1906, the Austrian side had no way to exert financial pressure on Belgrade. After being forced to abandon as ineffective its Tariff War in 1911, Vienna's lack of economic leverage opened the way for the same "militarization of diplomacy" as in the other Great Powers and the long-standing argument of the Austrian General Conrad for a "preventative war" against Serbia. [5]

During course of the war itself, it has been argued that economic rather than military disadvantage provides the best explanation for the defeat of the Central Powers by 1918. That is the conclusion offered by Malcolm Broadberry and Mark Harrison in their Introduction to the major set of Western studies of the war's economic costs and consequences, as supported by the chapters on Germany by Albrecht Ritschl and Austria-Hungary by Max-Stephan Schulze.[6] Among the ten chapters in all, however, there is none dealing with Southeastern Europe or any

---

[3] Clark (2013), Pp. xxviii; Bibliographic Essay by Jean-Jacques Becker and Gerd Krumreich in Winter, ed. (2013), P. 649. For a more detailed and dispassionate study of Serbian the July crisis of 1914, a downgrading of the strength and influence of the Apis organization of *Crna ruka* among Serbian arm officers that Clark emphasizes, see the chapter by Marc Cornwall, "Serbia" in Wilson, ed. (1995), P. 55-96.

[4] Herrmann (1996), Pp. 234-37. For a review of how the pace of German military spending supports the Fischer thesis, still minus a final decision for army chief Moltke's "preventative war" until Russian mobilization began in July 1914, see Strachan (2004), Pp. 66-78.

[5] Lampe and Jackson (1982), Pp. 230-37 and the classic study by Dimitrije Djordjević (1962), the present author's introduction both to Balkan economic history and Serbian scholarship. On the general "militarization of diplomacy" by the July crisis, see Stevenson (1996), Pp 360ff.

[6] Broadberry and Harrison, eds. (2005), Pp. 35-36, 41-111.

part of it. The present paper seeks to repair some of that deficiency. We have already seen the role that German financial strength and Austrian weakness played in the outbreak of the war. A British plan to force German surrender in a few months by destroying its financial system was aborted as unworkable once the war was underway.[7] After the war, it was British policy led by the Bank of England that provided an overriding framework for economic recovery now including Southeastern Europe. It was based on a return to the prewar Gold Standard rather than the prewar competition for favor in the region by state loans, a competition in which Britain had taken no part and which the defeat of the Central Powers would now leave entirely to France.

The costs of the war across Southeastern Europe were heavy, and chances of recovery without external support were slim indeed. Beyond the damage to property, whose calculation remains controversial, the huge cost in human capital and trade relations can be measured. The death toll of combatants and civilians for Serbia/Montenegro led the rest of Europe at 5.7 percent of prewar population, and Romania fell just short of the 3.4 per cent lost by France. Voluntary migration on the prewar pattern was minimal, and the forced migrations that now disrupted the region's settlement resulted in a net gain only for Greece. Its failed Anatolian campaign brought in 1.5 million refugees to balance the million, mainly non-Greeks who left. The Greeks forced out of Bulgaria, the Hungarians out of Transylvania, and the Albanians out of Kosovo did not much advance the fortunes of the Bulgarians, Romanians or Serbs who took their place. Overall, postwar birthrates declined, but lower death rates and reduced migration kept rural population density rising and arable land per capita rising. Only Bulgaria and Greece had seen their manufacturing sectors expand during the war, and then continue to expand afterward. Romanian oil production and Yugoslav mining had also expanded during the war, partly under occupation, and continued afterwards, Bulgaria did experience a significant rise in industrial labor after 1918, but even there the rural share of the population remained at the regional norm of 80 percent. The destruction of rolling stock, rail lines and shipping links hit Romanian agriculture the hardest, as exports initially plummeted and crops returned to 1913 levels only in 1929. The continuing absence of east-west or coastal rail connections across the new Kingdom of Serbs, Croats and Slovenes combined with the heavy war damage in Serbia to keep the potential of a large domestic market for economic integration from developing.[8]

As the region's economies struggled within new borders and with transferred populations and disrupted transportation, the initial assistance from the victorious Western powers was modest indeed. It does not bear comparison to the UNRRA aid after the Second World War or the largely EU funding after the wars of Yugoslavia's

7 See Lambert (2012).

8 Lampe and Jackson (1982), Pp. 329-433, and Broadberry and Harrison, eds (2005), Pp. 22-37.

dissolution. Food supplies from the US under the organization headed by Herbert Hoover provided $100 million worth, almost evenly divided between Romania and the Yugoslav Kingdom by the end of 1919, but barely $1 million to Greece. Bulgaria would subsequently receive $4.8 million but, as a wartime ally of the Central powers, only in return $2million in gold.[9] There followed in 1920 a proposal from the League of Nations to provide commercial credits for exports of needed primary and raw materials from individual Western firms, more specifically bonds to be secured by assets within the importing Central or East European country. A British banker was appointed to work out the details, but crucial American participation was absent. An effort to provide some lower-cost credit to Austria failed, and British officials treated the requests from Poland and the Yugoslav Kingdom skeptically. The international commission to facilitate what were called Ter Meulen credits, after its Dutch originator, was never formed. The project had vanished by 1922, leaving the Yugoslav Kingdom to obtain a loan for railway construction from the United States later that year, at a high 8 percent rate of interest with repayment tied to customs revenues.[10]

Meanwhile, to cope with postwar challenges posed to successor governments, the size of non-military state employment rose rapidly everywhere except Greece. In the course of the 1920s. the Yugoslav total tripled from prewar Serbia's already large numbers and Bulgaria's doubled, both of them falling short of the quarter million employed in Romania.[11] These huge totals were a domestic burden in their own right, compounded by lack of training for lower level administrators. Low salaries fed corruption, especially in less attractive locations like Bessarabia or Kosovo Its level may be judged from a crime rate for Bulgaria's state employees that was 400 percent of the 1910 level by 1926, versus 64 percent for the population as a whole.[12] The attraction to state salaries and the inefficiency of overstaffed ministries would be a legacy to the post-1945 Communist regimes and, as we shall see, to recent Greek experience.

THE STRUGGLE FOR FINANCIAL STABILIZATION

Western financial policy, led by Britain and the League of Nations rather than the United States, shared a common postwar priority with the governments of Southeastern Europe, but for different reasons. The British lead, followed by the League's Financial Committee, sought to restore the Pound and other currencies to their

[9] Surface and Bland, (1931), Pp. 164-235.
[10] Orde (1991), Pp 121-23.
[11] Lampe and Jackson (1982), Pp 501-5, Tables 12.20 and 12.22. By a contemporary Western estimate, Beard and Radin (1929), Pp 180-86, the Yugoslav total could have been cut by one third at no loss in efficiency.
[12] Lampe (1986), Pp 64-65.

prewar exchange rates under the Gold Standard, thereby subduing postwar inflation and the damage its persistence would do to capital markets. New York's challenge to London, including the huge US accumulation of gold reserves during the war, would be contained in the process. For Southeastern Europe, stabilizing their currencies at fixed rates of exchange backed by gold and reserve currency holdings offered the prospect of renewed access to Western capital markets, to loans repayable in currencies at attractive albeit overvalued rates of exchange. This new supply of badly needed capital and cheaper imports would make up for the smaller exports available for purchase at overvalued exchange rates. This was the bad bargain that famously cut into Britain's own exports and kept unemployment high through the 1920s. For our region, the lending that was supposed to follow from stable exchange rates enforced by independent central banks never came. Let us examine this common pattern before turning to distinctive features for Greece, Bulgaria, Romania and the Yugoslav Kingdom. Albania's fledgling economy, with its central bank founded in Rome and its financial support plus foreign trade under informal Italian control, could proceed with the inflationary note issue that the rest of the region and its potential creditors were determined to prevent.[13]

The other four regional economies saw their foreign trade struggle through the 1920s with note issues of currency much reduced from prewar levels and the pressure of surplus imports addressed with protective tariffs. Per capita foreign trade in constant exchange rates did increase everywhere but Romania, whose exports were barely half of the 1906-10 level for 1921-25, but significant trade deficits appeared everywhere but Bulgaria. There the lower level of overall increase could be traced in part to the peace treaty's restriction into 1925 on signing a new commercial agreement with another country. The sharper and more consistent reductions from prewar levels appeared in currency note issue and state budget expenditures. All of their governments and banks of issue had faced an immediate postwar inflation of their currencies, driving exchange rates down past 1,200 per prewar unit for Greece, past 1,400 for the Yugoslav Kingdom, and to 2,800 for Bulgaria and almost 4,000 for Romania by 1923. Under urging from the Bank of England in particular, as we shall see, they all reacted with concerted efforts to deflate and then stabilize their exchange rates, all at a cost to the domestic supply of investment capital. For 1926-30, only Greece's note issue exceeded 50 percent of the prewar level, and only its state budget could spend more in constant terms than it did in 1911. The other three showed greater reductions in note issue, particularly for 1926-30, and state budgets ranging from 47 percent of 1911 for Bulgaria up to 83 percent for the Yugoslav Kingdom.[14]

All four faced the further burden of war debts, or in Bulgaria's case reparations. Although reduced from their daunting 1920 levels by 1930, their constant values

[13] See the path-breaking study by Roselli (2006), Pp 33-42.
[14] Lampe and Jackson (1982), Tables 10.6, 11.1 and 11.2, Pp 343 and 380-84.

still exceeded the already sizeable 1911 levels, by only 3 percent for Yugoslavia but 29 percent for Bulgaria and 35 percent for both Greece and Romania. These obligations deepened deficits on current account, and in the aforementioned absence of Western loans, capital accounts failed to make up the continuing deficits on balance of payments.[15] In general, the four governments responded with protective tariffs, and West European banks provided the same sort of short-term capital that the US market gave to the German economy until the Depression cut the supply line disastrously short. Only small fractions of Western loans actually obtained were use for productive purposes like railway construction. But the specific cases give us a better understanding of the postwar consequences of these prewar financial priorities. Let us consider them in turn before concluding with some disturbing comparisons but more promising contrasts with the region's postwar experience, following first the Cold War and the wars of Yugoslavia's dissolution.

Greece was the one regional economy to start the postwar period with its currency still stable at prewar par, thanks to Allied credits that covered a massive issue of bank notes and an increase in the public debt from 1.4 to 2.4 million drachmas by 1920. But then the Anatolian incursion, far beyond the original, British-encouraged coastal expedition, made military expenses two thirds of skyrocketing state budget expenditures. By the time that incursion collapsed in 1923, two thirds of total expenditures had to be covered by new foreign credits plus a forced domestic loan. The public debt had tripled. In the process, the drachma's exchange rate for British Pounds had fallen from the prewar rate of 26.6 to 140 by mid-1922 and then down to 387. In 1920, the League's Financial Committee had approved the move away from the prewar gold standard adopted in 1910. In addition, remittances from the Greek diaspora which had helped to reduce the trade deficit had fallen to one third of their prewar level. These were the hard circumstances under which the new "Revolutionary Government" of the Republic declared in 1924 faced the accommodation of the 1.5 million refugees who had poured into northern Greece and Athens from Anatolia.

Mark Mazower's seminal study traces the accumulation of burdens and the failure of the post-incursion government to reign in the profits taken by domestic banks from the borrowing binge.[16] Their regime's initial effort abolished the Consortium of the five established banks, led by the National Bank of Greece. It had tried but failed to reign in black market currency speculation. Instead, the Liberal government imposed export duties and a 15 percent tax on bank exchanges of currency. The established banks continued to prosper, buoyed by a five-fold increase in net profits by 1922 after nearly as large an increase during the war years. Lacking the leverage of impose direct taxation, the Republic's government fell back on further tariff increases. The private economy also took advantage of the badly

[15] Ibid, Tables 11.3 and 12.25, Pp 428-29, 512-15.
[16] Mazower (1991), Pp 1-113.

fragmented set of labor unions to push down real wages, reversing their increase until 1922. The government's search for new Western loans was frustrated by the accumulation of war debts. Only the recourse to League loans for refugee resettlement would prove successful before a London agreement on war debts in 1927.

Already in 1923, Anglo-American support for a proposal from the League's Financial Committee overcame opposition from the Bank of England and began planning for a loan to finance a Refugee Settlement Commission RSC). The new Greek government had asked for such assistance and renewed the consultations with the Financial Committee that the Venezelos regime had initiated in 1920. By 1924, a League of Nations loan of 12.3 million Pounds was in place, albeit at 8 percent interest, with an American advance allowing the staffing of the RSC and its construction of refugee housing to begin. By 1927, its Greek-American leadership and largely Greek staff had housed half of the homeless refugees from Asia Minor. After the dismissal of the brief military regime of General Pangalos in 1926 and the aforementioned agreement on Greece's war debts to Britain, the restored Liberal government, again headed by Venezelos, could again turn to international capital markets. But the failure to agree even on the creation of a central bank or to restore the drachma to a fixed exchange rate under the gold reserve standard until 1928, both priorities for the Bank of England under Montagu Norman as we shall see, restricted access. The exception was a second refugee loan for the highly regarded RSC. The government's new Committee of Experts, working with the American leadership of the RSC and British representatives keen to reestablish their priority over US interest in Greece, pushed forward with a loan in 1928, as large as the first but at half the interest rate. Its arrival and new Greek borrowing for road construction allowed the RSC to announce in 1930 that the other half of the refugee influx had now been housed and connections between the largely northern settlements advanced. The ethnic Macedonian minority and also Greek peasants with claims to the settlement land suffered in the process, but otherwise the work of the RSC constituted the one significant Western contribution to postwar recovery in Southeastern Europe.[17]

Refugees, primarily from northern Greece, also flooded into Bulgaria as a consequence of the First World War. Their numbers, 220,000, were far smaller than the Greek total but their armed VMRO militants politically more volatile. They soon seized control of the Pirin region in the southwest and disputed the border with the new Yugoslav Kingdom. There would be no League loan even partly available for their settlement until 1926. This was hardly surprising since Bulgaria's government had been the only one in the region allied with the losing side. From 1918 there were still some prewar debts to pay to French bondholders anxious not to allow the Bolshevik precedent of repudiation to be repeated. And by 1921 a far

[17] The most recent refugee study, drawing on Greek as well as the long familiar Anglo-American sources, is Kontogeorgi (2006), pp 73-110 on the RSC in particular.

larger sum for reparations was due, half the state budget's annual revenues. This the Agrarian Party in power under Aleksandar Stamboliiski from 1919 refused to pay along with the prewar debts. Only some payments in kind to Yugoslavia and Greece were provided until the total due was cut by three quarters and the repayment period extended in 1923. The League's Financial Committee agreed to this concession only after a French proposal for military intervention had attracted no wider support and after Stamboliiski and his Agrarian government had been overthrown. Before then, only some desperately needed food supplies had been obtained from the US in 1919, worth $4,8 million but as noted above requiring a payment of $2 million in gold. The leva had already fallen to 75 percent of its 1911 value during the War and to 50 percent by 1918. German troop extraction of food supplies had mounted during the war, the resulting shortages threatening famine after the bad harvest of 1918. For the period of international isolation and antagonism from 1919 to 1922, the leva's exchange value declined seven-fold. Only in 1923 could Bulgarian reach accommodation with the League and the postwar financial framework that its Financial Committee was prescribing for all of the smaller Eastern states.[18]

The leading figure in shaping that framework was Montagu Norman, the powerful Governor of the Bank of England. Working with his close, originally Austrian colleague, Sir Henry Strakosch, they were determined to restore prewar financial stability by restoring the prewar Gold Standard. Under their influence, the League's reduction first in Hungarian and then in Bulgarian reparations were tied to the separation of the domestic central bank from commercial operations and its independence from the budgetary demands of the central government. This decoupling was to safeguard the money supply from the aforementioned inflation that had surged up as the war ended and decoupled their exchange rates from fixed prewar parities, with the French gold franc for our region. Even before Norman was able to restore the Pound Sterling precisely to its prewar rate of $4.86 in 1925, he was advocating the widespread restoration of fixed rates backed by gold and Pound reserves. He and Strakosch envisaged the creation of an international consortium of central banks that would operate independently of their respective governments, inviting comparison with present EU efforts to create a Banking Union.[19] Because of its vulnerability over reparations, Bulgaria was the first state in Southeastern Europe to stabilize its currency well below the prewar rate of exchange but fixed under the new gold reserve standard. In 1924 the leva's value was thereby set at 3.8 percent of the prewar rate, less than half the 8.9 percent at which the Yugoslav Kingdom was stabilized the following year but still well above the leva's market rate of 2.7 percent in 1923. To maintain this overvalued exchange rate, the Bulgar-

[18] Lampe (1986), Pp 60-64.

[19] P. L. Cottrell, "Norman, Strakosch and the development of central banking, 1918-1924" in Cottrell, ed. (1997), pp 29-74; Boyce (1987), Pp 39-47.

ian National Bank (BNB) restricted note issue and eliminated its state loans. The pressure on the state budget was only slightly relieved by the two League loans that were finally provided in 1926 and 1928.

As detailed by recent Bulgarian scholarship, the BNB restrictions and the pressure to reduce deficits in the state budget significantly reduced available funds. Roumen Avramov has called the postwar economy "capitalism without capital".[20] The newly limited lending from the BNB shrank to less than 10 percent of bank credit by 1928, versus one third before the war. Its ratio of reserve assets to note issue was the highest in the region and its discount rate among the highest. State budgets struggled to cut annual deficits under 20 percent by the late 1920s, pressing to keep import and export tariffs in place and raise indirect taxes. Stamboliiski's direct taxes on higher incomes and his Grain Consortium to raise export prices could be not maintained in the face of objections from the League's Financial Committee.. Tariff revenues were still called upon as guarantees for the two League loans of 1926 and 1928. The first came through the London and New York capital markets and the second from London alone. They realized only 2.9 and 5 million Pounds respectively, far short of the two 12 million Pound loans to Greece. Large fractions of both loans simply went to settle prewar debts. Supposedly stepping in to fill the funding gap were the five West European banks that did indeed provide almost half of the credit available for 1924-29. But their initial disposition to invest in industry soon faded, despite its rapid growth from a small base. The postwar economy was left with abundant short-term commercial credit but not the long-term funding to which a fixed, overvalued exchange rate was supposed to draw European investors.

Romania's economy entered the postwar years with much better prospects to attract foreign investment in return for a currency fixed under the new gold reserve standard as advocated by the Bank of England in particular. But it was almost the last state in Southeastern Europe to adopt the new standard and did so only under sponsorship from the Bank of France in 1927, a year before Greece as noted above. By then, the resistance to paying war debts to the Western allies had combined with the aforementioned reaction to the region's largest postwar inflation exerted enough downward pressure on the leu to keep the constant per capita value of note emissions from the Bank of Romania at barely half their 1911 or 1920 levels. Here was the same sort of deflationary pressure that the gold reserve standard itself was supposed to provide.

Meanwhile, mining (oil and coal extraction) and attendant metallurgy doubled their production in the 1920s, after recovering from wartime losses to take advantage of the mineral resources in newly acquired Transylvania. But the attraction to direct foreign investment suffered not only from the uncertainty about debt repayment and currency rates but also the one major nationalization undertaken

[20] Avramov, I (2007), 260-93; Vachkov and Ivanov (2009), Pp 9-41, 60-80.

across the region in the wake of the First World War. The defeat of Germany and Austria-Hungary left their oil enterprise, equal in size and capital to the West European and US competitors that had flocked in since the 1890s, open to expropriation. Steua Română now became a state enterprise, although by the early 1920s it was already obliged to seek new investment funds in the Paris and London capital markets. Then in 1924, the National Liberal government used its predominant position, secured by the disappearance of its prewar Conservative rivals after their siding with the Central powers, to pass a new Mining Law. For oil and also coal extraction, it required 55 percent Romanian ownership and management of all foreign enterprises for mineral extraction frm state land, plus two thirds of the Board of Directors. Royal Dutch Shell and the other large West European companies reluctantantly complied. Only the American Rockefeller interests refused. But the US State Department then refused their request that Romania be given a significant concession on the repayment of war debts in return for an exemption to the Mining Law. The Rockefeller access to operations in Romania were thereby reduced, and the attraction of new investment from the other Western oil companies also declined.[21] The new National Peasant Party government elected in 1928 was determined to relax these restrictions on direct foreign investment, but its measures had little effect once the Great Depression descended from 1929 forward. .

Attention should also be paid to the wartime and immediate postwar background to the Romanian failure to take greater economic advantage of its larger territory and resources. The momentum for the postwar inflation began during the last year of the First World War when the German occupation of Bucharest allowed a German-backed bank there to begin issuing lei at the same time that the long established National Bank was issuing notes from its location in Iaşi. The German authorities soon broke their promise to issue notes only for military purposes, so that the combined value of lei in circulation rose by one half in the course of 1918. Then came the postwar acquisition of Transylvania and the Banat, and with them the large amount of Austro-Hungarian crowns still left their in circulation and in bank deposits. Realizing the further inflationary potential of their conversion to lei, the leadership of the National Bank argued for a high rate of conversion, at 5/1 or more. But the several Liberal banks in Bucharest demanded a lower rate so as to facilitate their interest in attracting crown deposits. This tactic also favored the consolidation of Liberal political leverage in Transylvania over its large and reluctant Hungarian minority. It won the day, and the stamping of some Austro-Hungarian crowns begun in 1919 was followed in 1920 by their full conversion to lei at a rate of 2/1. The conversions accounted for a large part of the now doubled note issue and the accelerating inflation. Too slow to carry out their wartime promise for land reform, the now National Liberals were briefly forced from power in 1921. A non-party regime under General Averescu launched the land reform

[21] Pearton (1970), Pp 10-50.

and its redistribution of land from large estates, also demobilizing some 200,000 army troops to aid in rebuilding damaged infrastructure. To cover some of the cost and also to replace inflation with deflation, his Finance Minister instituted a progressive income tax and a tax on war profits. But bank interests close to the National Liberals refused to provider the credits needed to proceed ahead until tax revenues accumulated.[22] By 1922, the National Liberals had returned to power, finally going ahead with land reform but also maintaining the large army whose support strained the beleaguered state budgets. The National Bank continued to increase note issue, mainly to support expanded credit through its new branches in Transylvania and the Banat, in competition with a set of Liberal bank branches. It was left to the National Liberals to change course and introduce the most sharply deflationary measures in the region. In late 1924, its Finance Minister, the powerful brother of the Prime Minister, Ionel Brătianu, placed statutory limit of note issue from the National Bank, tying its total to 25 percent of gold reserves The two brothers wished to resist any supervision from the League's Financial Committee, let alone allow the British influence of Norman and Strakosch. Romania would thus proceed on its own (*prin noi* înşine) to pursue a convertible currency just as its industrial policy sought to rely on domestic management. Hence the huge reduction in note issue noted above and a sharp restriction in credit available only at 20 percent rates of interest. Still, only with sales of foreign exchange and further deflationary pressures could the leu be sufficiently stabilized in 1927 and proceed ahead under the gold reserve standard.[23]

It is ironic that the Romanian adoption of yet another overvalued rate of exchange, albeit the lowest one in the region at 3.1 percent of the parity with the French gold franc, could find sponsorship, as noted above, only from a country whose own currency was significantly undervalued. France had struggled itself from 1919 forward with its war debts to the US and also Britain, hoping to cover them with German reparations. But when the ill-advised French occupation of the Ruhr in 1923 failed to yield the expected compensation, its government was forced to accept the Dawes Plan for reduced and much prolonged reparation payments from Germany and also Hungary and Bulgaria. A bookkeeping scandal in the Bank of France in 1925 over note issue beyond the statutory limit of 1919 accelerated the depreciation of the Franc and brought back Rayond Poincarê to form a new government in 1926. His new governor of the Bank of France, Êmile Morneau, took advantage of political stability, rising exports and Pound reserves to stabilize the rising exchange rate for the franc under the gold reserve standard before it stopped rising. The franc would therefore remain undervalued for the rest of the 1920s before suffering in the 1930s for not leaving the gold reserve standard and what had

[22] Durandin (1985), Pp 45-68.

[23] Kirițescu, II (1967), passim, Daniel Dianu, "The role of finance in Romania's quest for modernization, insights from the interwar period" in Cottrell, ed. (1997), Pp 145-90.

become a relatively overvalued rate. Morneau was anxious to deny Norman further influence and assert French authority in Eastern Europe beyond the several banks who had rushed in to replace German and Austrian investors where they could. Advisors from the Bank of France were also more welcome in Bucharest than any from the Bank of England or the League's Financial Committee. But the French promise of a stabilization loan that would compensate for overvaluation could not be provided until 1929, when the Depression impended.[24]

The Kingdom of Serbs, Croats and Slovenes had already stabilized the dinar under a fixed if also overvalued rate in 1925. It did so under British encouragement but without formal adherence to the gold reserve standard or a stabilization loan until accepting the standard in 1931, just as Britain left gold. This step was the famous initiative of Milan Stojadinovic, later a Prime Minister (1935-38) favoring state-led industrial policy but from 1923 a Finance Minister following Norman's financial orthodoxy. First trained in Germany, he had established postwar connections with economists in London. Stabilization at the region's highest fraction of prewar parity, 8.9 percent, reflected the earlier success by the central bank, now renamed the National Bank of Yugoslavia (NBY) , in restraining postwar inflation and falling exchange rates for the currency more rapidly than its counterparts around the region. But to push the Geneva exchange rate for the dinar up enough to fix its value, Stojadinovic forced a one third reduction in note issue on the NBY from 1924 to 1926. A new land tax was to help close the state's budget deficit while the stable dinar was to attract foreign loans and investment. The loans never came, and the bad harvest of 1926 reduced revenues from the new tax. Left with the deflation needed to maintain another of the region's overvalued exchange rates, the latest in the series of Serbian-led coalition governments passed protective tariffs in 1927 for agriculture as well as industry. Based in Belgrade and assuming its wider role for the prewar National Bank of Serbia, the bank's role in replacing inflation with deflation were seen as continuing a pattern perceived as conscious discrimination against non-Serb-areas. In Croatia in particular, this was a pattern believed to begin immediately after the war with the creation of the bank and its sole right of note issue.

The First World War had aggravated the financial problems of connecting Serbia with territories under Austrian, Hungarian, or Austro-Hungarian administrations before 1914 and before 1912 under Ottoman rule. The Austrian and Bulgarian occupation of Serbia, Macedonia and Kosovo from 1915 to 1918 had introduced their currencies but no capital investment. Meanwhile, the western Habsburg lands had remained disconnected from each other and under Austrian or Hungarian administrations that could not coordinate a united war effort. The major grain-growing areas in Slavonia and Vojvodina sent their produce to Budapest while starvation

[24] Kenneth Moure, "French money Doctors in the 1920s", inFlandreau (2003), Pp 138-65; Ahamed (2009), Pp. 141-69.

threatened Vienna by 1917-18 and continued to do so into 1919 in the absence of an agreed alternative to Hungarian crowns. The Austrian occupation in Belgrade made no effort to construct the railway to Hungarian controlled Zagreb that would have served the Yugoslav Kingdom so well after the war. By 1919, six different currencies were circulating, only the dinar having been issued within the new Kingdom's borders. And it took most of the year before agreement could be reached on a single new bank of issue.

The major problem facing the new National Bank of Yugoslavia (NBY) was the presence of Austrian or Hungarian crowns issued under their single state that no longer existed. Here was the same postwar challenge that the National Bank of Romania had faced in Transylvania and the Banat. Its answer, as noted above, was a favorable 2/1 rate of exchange that would keep deposits in banks opened of taken over by interests of the ruling Liberal Party. There was no such option for the Serbian Radical Party dominating the new Belgrade ministries but not the parliament or the large surviving banks in Croatia or Slovenia. Their supporters pushed for crown conversion at 10/1, while 1/1 or at most 2/1 was the response from Zagreb or Ljubljana. The NBY choice of 5/1, later trimmed to 4/1 in 1920 thus represented the sort of compromise that would prove illusive in the subsequent economic history of the interwar Kingdom. Still, this rate of exchange was roughly the same as the open market rate being offered for crowns exchanged for francs in Vienna. This is a story long familiar from publication based on the author's initial research in the archives of the Bank of Yugoslavia.[25]

New research from Serbia has now added to our understanding of the trials during the initial postwar period, trials in which the presumed Serbian hegemony faced a set of disconnected territories in which Belgrade's authority was either challenged or ignored. The familiar struggles of the new NBY to assemble capital from more than Serbian sources is only one example. Three sales of bank shares into 1921 were needed to raise the desired capital of 40 million dinars. The increasingly favorable terms for delayed payment, finally in bank notes, attracted only one quarter of its final total from outside of Serbia. The large Zagreb banks were conspicuously absent, understandably so given interest rates for credit of 13-21 percent, versus the modest 8 percent available from the NBY. From this small non-Serbian share in the NBY' s founding capital would follow, not surprisingly, followed discount credits in Serbia that were twice those in Croatia and four times those in Slovenia. This imbalance posed no difficulties for the western lands in the 1920s. Their banks built on the attraction of deposits and capital from the disconnected financial sectors of Vienna and Budapest in the immediate postwar period and then prospered with support for enterprises with easier access than Serbia's

[25] John R. Lampe. "Unifying the Yugoslav Economy, 1918-1921: Misery and Early Misunderstandings" in Djordjević, ed. (1980), Pp 139-56. Useful detail may be found in tn the bank's own published history, *Narodna Banka* (1934), Pp 92-118.

to export markets, in distance and available transport. While the new central bank in Belgrade was failing to ground itself more broadly, the new central government also found that its fiscal reach fell far short of the hegemonic control for which it would later be blamed, especially in the 1930s. Ivan Besić begins his survey of postwar financial policy by reviewing the first state budgets, none of which the Finance Ministry was unable to pass as presented to the Serbian-dominated parliament until 1923. Temporary decrees were needed for 1919-22. Enough lower level financial and trade officials from the prewar period remained in place in the western lands to keep the Serbian-controlled Belgrade ministries from collecting uniform taxes or preventing trade blockades between Croatia and Slovenia for instance. Meanwhile in Belgrade, the Finance Ministry was unable to prevent a combination of royal and army influence from arranging unsecured foreign loans, primarily to support new military spending.[26] Its use to consolidate central control in Kosovo and Macedonia contrasts with the weak state framework and the limited economic coordination that connected rest of the new Kingdom of Serbs, Croats and Slovenes by 1923.

These disconnecting postwar consequences formed the background for the hard deflationary measures undertaken by Stojadinović's Finance Ministry from 1923 to 1925. Externally, they were successful. By 1925, the restriction of note issue had advanced the dinar's exchange rate by 50 percent and reduced its destabilizing fluctuations in the process. A legal statute of 1926 then set a fixed rate based on the Geneva exchange for gold reserve currencies. The recent review of interwar currency and foreign exchange policy by Goran Nikolić emphasizes the positive side of this belated centralization. The dinar remained stable through rest of the 1920s and its high exchange rate did attract more foreign capital if not foreign loans.[27] But the resulting restriction of credit and upward pressure on interest rates and export prices did more than push the Belgrade government toward the aforementioned protective tariffs of 1927. It opened the country's financial center that had grown up in Zagreb around its private banks to the danger of an overvalued exchange rate if a downturn in the international economy reduced trade and capital flows. As detailed in a recent Croatian study, this is exactly what happened in the Great Depression, although without the political bias in Belgrade assumed by earlier scholarship from Croatia. [28] Already in 1928, pressure especially from Croatian industry proposed a reduction in the dinar's exchange rate, but it was unsuccessful. The full impact of Depression in the 1930s left Zagreb banks at the mercy of runs on deposits and the inability of borrowers to repay. The leverage of the NBY, neglected outside of Serbia in the 1920s, now shifted the financial center of Yugoslavia from Zagreb to Belgrade. But the shift was largely the result of the

[26] Besić (2003), Pp 39-107.
[27] Nikolić (2001), Pp 219-21.
[28] Ivo Bićanić and Željko Ivanović, "Croatian Banking during the 1926-1936 Depression', in Green, Lampe and Štiblar, eds. (2004), Pp 64-83.

unbroken emphasis on monetary stability that had been the principal economic consequence of the First World War for all of Southeastern Europe.

CONCLUSIONS PAST AND PRESENT

What lessons may then be drawn from the limited economic causes and widespread economic consequences of the First World War for this region known as Southeastern Europe only from the war's end? Of course the first lesson from both 1914 and 1918 is to avoid the temptation to draw historical parallels too easily tied to current events and then read backward. A French philosopher once called such temptations "the illusions of retrospective determinism". Setting aside the political and 9/11 terrorist parallels tempting some recent scholarship on the Sarajevo assassination in 1914, the economic causes of the First World War still seem limited. Worth noting however are the prewar German buildup of the army ordinance needed to invade France and the Austrian turn to military action against Serbia in the absence of financial or commercial leverage. The comparable economic lessons for the wars of Yugoslavia's dissolution would be the large arms production for a large army that created the capacity for full-scale war combined with a failing national economy whose disconnections invited regional rivalry. Otherwise appropriate plans for economic reconnection, under the financial leadership of the NBY, foundered when left to the mixture of Communist and Serbian nationalist imperatives of the Milošević regime. The Communist leadership of Croatia and Slovenia led the rejection, and the League of Yugoslav Communists soon ceased to exist.

While the economic consequences of the First World War suggest only contrasts to the end of the Second World War, the quarter century that has now passed since the end of the Cold War invite considerable comparison. In 1945, the old political order that had continued in 1918, albeit within new borders for Southeastern Europe, was gone. On the Western side, the American economic predominance was even greater than in 1918 and its leaders were now determined, even before the start of the Cold War not repeat the earlier postwar retreat from European recovery. This was the major lesson of post-1918 period, as frequently stated by US authorities. UN membership was accepted, not rejected as with the League of Nations, and most of the aforementioned UNRRA aid came from the United States.. Nor was the Soviet side, although weakened by its war effort, ready to retreat from Eastern Europe. The need for rapid reconstruction justified the demands of its allied or subordinate Communist parties for exclusive political control. Then Cold War competition between the two sides led to direct American aid to Greek agriculture and Yugoslav infrastructure that advanced their economic development. Soviet support in Bulgaria, Romania and now Albania pushed heavy industry ahead and opened the large Russian market to Bulgarian agriculture and light industry. The financial imperatives of the post-1918 years were secondary at best, and there was no interest in restoring the interwar monetary order or the gold reserve standard that it had discarded in the 1930s.

The end of the Cold War left only the Western side standing. The initial economic failings of the successor regimes in the now independent Yugoslav republics as well as in Bulgaria, Romania and Albania brought back the Western emphasis on financial stability as the first step to postwar recovery. Weak or politically dependent central banks could not prevent pyramid schemes and catastrophic inflations in Bulgaria and Albania as well as Serbia. Crony capitalism that left large enterprises, even if formally privatized, in the hands of political insiders, cut short what appeared to be promising increases in Croatia and Romania in Gross Domestic Product (GDP). Western aid, primarily from the European Union, and rising EU trade helped to reduce balance of payments deficits, uniformly exceeding the limited totals for foreign direct investment (FDI).[29] Here was evidence to support the so-called Washington Consensus established in the World Bank and the International Monetary Fund (IMF) from their experience with inflationary Latin American economies in the 1980s. Then with the end of the wars of Yugoslavia's dissolution in 1999, the EU and the World Bank jointly agreed on further aid to what was now called the Western Balkans, the Yugoslav successor states minus Slovenia plus Albania. Dubbed the Stability Pact, its major aim was to create the financial stability that would open the way not just to competitive privatization, increased trade and direct foreign investment but most importantly the path to EU membership that had been previously opened only to Slovenia.

Regional attraction to this open door combined with an upsurge in direct foreign investment to increase growth rates in the Western Balkans and bring Slovenia, Bulgaria and Romania into the EU before the international financial crisis of 2008 set them all back. It is this most recent postwar period that raises the major issues for useful comparison to the post-1918 period. Let me draw on my own recent scholarship, which has has been primarily concerned with these past 15 years, to put forward a number of positive differences, suggesting lessons learned, and several unfortunate similarities, suggesting lessons yet to be learned.[30] Obviously, the existence of three new international institutions, the EU, the World Bank and the IMF, were major differences and I think advantages, especially when they soon stepped away from deflationary austerity and supported what its representatives called the Post-Washington Consensus. The EU provided the most financial assistance, rising to 5 billion Euros for 2000-06 and 10 billion for 2007-13. World Bank and IMF lending promoted the fiscal reforms and restraints in state spending that limited budget deficits with some reduction in public employment before

[29] Lampe (2006), Pp 291, Table 8.2.

[30] Lampe (2014), Pp.270-308 for all of Southeastern Europe, , and for the Western Balkans, see Cohen and Lampe (2011), Pp 386-447, 462-73.

the financial crisis and helped to survive reduced revenues since then. No crash programs like Stojadinović's to restrict Yugoslav note issue in the 1920s were undertaken. Instead, the region's various central banks used the independence that Norman had promoted in the 1920s to assemble professional staffs, advise their Finance Ministries and maintain stable exchange rates. Their rising reputations in the international financial community served their economies well, especially after the financial crisis. And all sides were assisted by the determination to proceed ahead with free trade and access to EU and regional markets, consciously avoiding the turn to protective tariffs that been so common in the 1920s. Instead, the magnetic attraction of European integration as the only alternative to the divisions of the 1930s has survived even under its recent trials.

Against these positive features and lessons learned, we must acknowledge a mixed record for the foreign banks that became even more prominent in the region than in the 1920s. More troubling has been the export burden from exchange rates stabilized around an overvalued Euro, and the failure of Greece, an EU member since 1981, to avoid the worst debt crisis faced by any European economy in 2008. The largely West European and Greek banks that provided much of the credit for the 2002-7 boom stepped into former Communist economies where banks had functioned only as secondary agents for distributing state funds for investment. The arriving foreign banks thus provided services closed off to domestic banks before 1989. At least they did not collapse or leave as their counterparts did after 1929, but high interest rates and newly restrictive terms have kept the credit supply reduced since 2008. The attraction of earning profits in currencies at rates of exchange matching an increasingly overvalued Euro has not served to keep large inflows of foreign direct investment in place any more than it did for the more limited foreign funds of the late 1920s. In the meantime, the region's trade deficits have risen with the effect of the general European slowdown on overpriced exports. With FDI reduced as well, regional governments have been pushed back into more borrowing. Croatia's foreign debt recently surpassed GDP, matching the Yugoslavia's troubled level in the early 1980s.

But the region's major debtor remains Greece. Here we should resist the temptation to blame the large Greek banks, with a couple of exceptions. The major source of the Greek problem has ironically been a state sector and employment expanded significantly in the 1980s and supported by informally forced loans from the large banks since then. Making matters worse were the missing standards for accurately reporting national accounts, otherwise well observed in the region under EU and central bank observance. Still, as Greek reforms now proceed ahead under the hardest austerity imposed on any of the region's populations, we may hope that the various postwar lessons learned in the rest of the region will allow it to contribute to representing what is now the southern European side in working with the German-led northern side and finding a way forward to a banking union and a common fiscal framework. Relying solely on a financial framework based on a stable exchange rate holds no more promise than it did after the First World War.

REFERENCES

Ahamed, Liquad (2009), *Lords of Finance, The Bankers Who Broke the World*, The Penguin Press, New York.

Avramov, Roumen (2007), *Komunalniat kapitalizum, I, iz Bulgarskoto stopansko minalo*, Center for Liberal Strategies, Sofia.

Beard, Charles A. and George Radin, *The Balkan Pivot, Yugoslavia*, Macmillan New York.

Becić, Ivan M. (2003), *Finanska politika Kraljevine SHS, 1918-1923*, Stubovi kulture, Belgrade.

Boycc, Robert W.D. (1987), *British Capitalism at the Crossroads, 1919-1932,* Cambridge University Press, Cambridge.

Broadberry, Stephen and Mark Harrison, eds (2005), *The Economics of World War I*, Cambridge University Pres, Cambridge.

Clark, Christopher (2013), *The Sleepwalkers, How Europe Went to War in 1914,* Harper Collins, New York.

Cohen, Lenard J. And John R. Lampe (2011), *Embracing Democracy in the Western Balkans, From Postconflict Struggles toward European Integration,* Woodrow Wilson Center Press, Washington, D.C. and Johns Hopkins University Press, Baltimore.

Cottrell, Philip L., ed (1997), *Building the Financial System of Central and Eastern Europe, 1918-1994,* Scolar Press, Aldershot, UK.

Djordjevi, Dimitrije (1962), *Carinski rat Austro-Ugarske I Srbije, 1906-1911,* Istorijski Institut, Belgrade.

———, ed. (1980), *The Creation of Yugoslavia, 1914-1918,* Clio Press, Santa Barbara, Calif.

Durandin, Catherine (1985), " Romania, the War and the Army, 1914-1930", *War and Society*, Vol 3, No 2, Pp 45-68.

Flandreau, Mark, ed. (2003), *Money Doctors, the Experience of International Financial Advising, 1850-2000,* Routledge, London.

Green, Edwin, John R. Lampe and Franjo Štiblar, eds. (20040, *Crisis Renewal in Twentieth Century Banking,* Ashgate, Aldershot, UK.

Hastings, Max (2013), *Catastrophe 1914: Europe Goes to War,* Alfred A, Knopf, New York.

Hermann, David G. (1996), *The Arming of Europe and the Making of the First World War,* Princeton University Press, Princeton, N.J.

Kirițescu, C. C. (1967), *Sistemul bănesc al leului şi precursorii lui,* Vol II, Bucharest.

Kontogiorgi, Elizabeth (2006), *Population Exchange in Greek Macedonia, The Rural Resettlement of Refugees,* Clarendon Press, Oxford.

Lambert, Nicholas A. (2012), *Planning Armageddon, British Economic Warfare and the First World War,* Harvard University Press, Cambridge, Mass.

Lampe. John R. (2006), *Balkans into Southeastern Europe, A Century of War and Transition,* Palgrave Macmillan, London.

——— (2014), *Balkans into Southeastern Europe, 1914-2014, A Century of War and Transition,* 2nd ed., Palgrave Macmillan, London.

———(1986), *The Bulgarian Economy in the Twentieth Century,* Croom, Helm, London.

——— and Marvin R. Jackson, *Balkan Economic History, 1550-1950, From Imperial Borderlands to Developing Nations,* Indiana University Press, Bloomington, Ind.

MacMillan, Margaret (2007), *Paris 1919: Six Months that Changed the World,* Random House, New York.

——— (2013), *The War that Ended Peace, The Road to 1914,* Random House, New York.

Martel, Gordon (2014), *The Month that Changed the World, July 1914.* Oxford University Press, Oxford

Mazower, Mark (1991), *Greece and the Interwar Economic Crisis,* Clarendon Press, Oxford.

Narodna Banka, 1884-1934 (1934), Exuviate a izradu novćanica, Topćider.

Nikolić, Goran (2001), *Kurs dinara I devizne politike Kraljevine Jugoslavije, 1918-1941,* Stubovi kulture, Belgrade.

Orde, Anne (1991), *British Policy and European Reconstruction after the First World War,* Cambridge University Press, Cambridge.

Pearton, Maurice (1970), *Oil and the Romanian State, 1895-1948,* oxford University Press, London..

Roselli, Alessandro (2006), *Italy and Albania, Financial Relations in the Fascist Period,* I. B. Tauris, London.

Stevenson, David (2004), *Cataclysm, The First World War as Political Tragedy,* Basic Books, New York.

Strachan, Hew (2004), *The Outbreak of the First World War,* Oxford University Press, London.

Surface, Frank M. And Raymomd L.Bland (1931), *American Food in the World War and Reconstruction Period,* Stanford University Press, Stanford, Calif.

Wilson, Keith, ed. (1995), *Decisions for War 1914,* St. Martin's Press, New York.

Winter, Jay, ed. (2013), *The Cambridge History of the First World War,* Vol. I, *Global War,* Cambridge University Press, Cambridge.

Vachkov, Daniel and Martin Ivanov (2009), *Bulgarskiiat vunshen dulg mezhdu dvete svetovni voini, 1919-1944,* Bulgarska Narodna Banka, Sofia.

Chapter 3

Theories of Imperialism and the First Globalization – Any Relevant Analogies?

Ivan Vujačić*
E-mail: <ivujacic@ekof.bg.ac.rs>

Abstract: The rise of empires and imperial rivalries that are widely considered to be at the heart of the causes of the First World War also gave rise to the first modern globalization. Theories of imperialism which tried to explain these phenomena were mostly, but not solely, based in the Marxist tradition. While there are some important differences in the approaches of individual authors, their most important claims are that imperialism is inexorably linked to capitalism and stems from its essential logic, and that it stimulates development in the regions of its expansion. These theories differ from Marx's, as well as from later neo-Marxist approaches. The paper analyses possible analogies between the globalization preceding the First World War and the current globalization as seen partly through the analytical framework of the theories of imperialism. Given the structure of the world economy it is likely that theories of imperialism will continue to be a part of the theoretical explanations of the capitalist world economy. Analogies between the first modern and the current globalization in terms of the structure of the world economy are also highlighted both in terms of similarities and differences.

Key Words: 1. Imperialism 2. Marxism 3. Globalization

JEL CLASSIFICATION: B14, F54, F63

1. INTRODUCTION

The last couple of years have seen a flourishing of literature related to the centenary of the outbreak of World War I.[1] Most of this literature shows the compounded mistakes of the decision-makers, the failure of diplomacy, and the lack of perception of the consequences of the war. Some of this literature goes into minute detail, tracing the events and decision-making among the political elites in the month of

* Institution/Affiliation: The Faculty of Economics, University of Belgrade. Research for this paper was supported by the Ministry of Science and Technological Development of the Republic of Serbia through project no.179065.

[1] Clark.C., (2013), MacMillan,M. (2013), Hastings,M.(2013).

July 1914 on a daily basis.[2] Most of these new studies make extremely interesting reading and throw light on the slide into war. Nationalism, militarism, perceptions of prestige, and certainly the technology of war all played a role and have been constantly present in the vast literature on the causes of the cataclysm that was to be World War I.[3] Most historians would agree that war could have been avoided at the particular moment of the Sarajevo assassination in June 1914. This stems from the methodological assumption that there is no inevitability in human affairs. Still, historians differ as to the weight of the factors that influenced the major actors to adopt a specific pattern of behaviour that led to this historical event. The real issue is whether or not the interaction of factors leading to war "over-determined" the final outcome.

Certainly there were numerous factors that facilitated the road to war. From an international geopolitical perspective, the shifting alliances from the Holy (Russia, Austria, Germany) to the Dual (Austria, Germany) to the Triple (Austria, Germany, Italy) Alliance were destabilizing. This led to the formation of the Franco-Russian Alliance, later to be complemented with a series of agreements with Britain, which turned these arrangements into the Triple Entente. The arms build-up on the part of Germany and its effort at countering Britain's dominance of the seas through a vast expansion of its navy certainly created suspicion and uncertainty. Domestic politics also played a role. Growing nationalism in France, which inflamed paranoia (the famous Dreyfus affair) and rekindled historical resentment, must have been seen as an ominous and threatening sign. The rise of the left and socialist parties in both France and Germany and the ethnic tensions in Austria-Hungary all stimulated perceptions by the ruling elites that domestic political troubles could at some point be overcome by whipping up patriotic fervour and foreign conflict. The widespread perception on all sides was that the war would be short and decisive. This led to a constant assessment, given the ongoing arms race, of what would be the best time for pre-emptive war in order to effectively use a current, but possibly dwindling, comparative military advantage. All of these factors played a role and must have had a synergetic effect at the crucial moment. But were they enough, or was there more to it? Were there deeper economic and systemic causes? Why it was so easy for a world economically integrated like never before and on the road to rising prosperity to fall into the abyss of war and devastation?

[2] McMeekin,S. (2014).

[3] The classic title on the planning and technological role played by the railways in mobilizing and transporting armies is, of course, Barbara Tuchman's, *The Guns of August*. (Original 1962).

2. GLOBALIZATION AND EMPIRE

World War I was a clash of empires – the British, German, French, Russian, Ottoman and Austro-Hungarian Empires were the major actors, drawing others into a military conflict on a global scale. Just this very fact would beg the question of the relationship of empire as such to the outbreak of war on a world scale. In the decades preceding World War I the expansion of empire was so intertwined with the steep rise of the global economy that it is perceived as the era of the first modern globalization. Are these processes linked and, if so, in what way and what are the consequences?

There can be no doubt that in the decades immediately preceding World War I there was a period of rapid growth and unprecedented prosperity by the standards of the times. Now there is almost universal agreement that the period 1870-1913 showed remarkable growth and a deepening of integration of the world economy. The period, however, should not been seen as homogeneous. In other words the contemporaries of the time saw the period from 1870-1895 as one of "Great Depression" (the term was originally coined at the time). The reason for this pessimism was the lack of gold, which under the gold standard defined monetary aggregates. In other words, until the discovery of new gold mines (circa the mid-1890s), there was a prolonged period of falling prices and falling profits, at least in some sectors such as agriculture. In this period there was a populist movement against the gold standard for that very reason. Nevertheless, due to technological innovation and rise in productivity, there was vast growth in the real sector.[4]

What immediately catches attention is the comparative dynamism of the Western offshoots (USA, Canada, Australia, and New Zealand) and Latin America in GDP, population, and GDP per capita growth. At the same time Eastern Europe and Russia were showing stronger growth rates in both population and GDP growth than Western Europe. In short, GDP growth rates, with the exception of Asia (excluding Japan), had risen significantly, along with the importance of exports as a share of the economies of the major regions as compared to the preceding period (1820-1870). Growth rates for the volume of exports were higher than for GDP. Trade largely rose due to technological advances in transport, which led to lower costs and almost quadrupled in the period.[5]

The period was also characterized by a shift in manufacturing. With the rise of the United States and Germany their share in world manufacturing rose, while Britain's declined. Nevertheless, Britain remained the most industrialized country on a per capita basis. The shift in manufacturing is shown in Table 1. It must be noted that contrary to the belief that manufacturing was the way to higher per capita incomes, the truth is that many of the Western offshoots (including the

4 Maddison, A. (2006), p. 126.
5 Maddison, A. (2006), p.127

Table 1. Percentage of World's Manufacturing Production

Year/Region	USA	UK	Germany	France	Russia	Other developed	Other
1830	2.4	9.5	3.5	5.2	5.6	13.3	60.5
1860	7.2	19.9	4.9	7.9	7.8	15.7	36.6
1913	32.0	13.6	14.8	6.1	9.2	17.8	7.5

Source: Biaroch (1982).

United States) saw substantial growth in GDP per capita, reaching and surpassing the most developed countries, while remaining dominantly primary and agricultural exporters. This was certainly the result of favourable terms of trade during the period of global expansion. It also provided for the virtuous circle between North America and Europe that will be described subsequently.

The flow of capital and foreign direct investment also figures prominently in the literature on the world economy before 1914. A great deal of it is focused on Britain, which stems from the fact that it was by far the largest investor abroad, with close to half of all foreign investment in the world at that point in time.[6] While France and Germany were mostly investing in Europe, almost two-thirds of Britain's investment was in the Western offshoots and Latin America. A large part, around two-thirds, was investment in transportation (mostly railroads) and public utilities and was in the form of government loans and public utility guarantees.[7] In other words, foreign investment rose rapidly and mostly took the form of portfolio investment. Foreign direct investment was mostly involved in the extractive raw materials sector. Table 2 shows the actual figures of capital invested abroad and their destination by region in the year immediately before the outbreak of the war.

Table 2. Gross Nominal value of Capital Invested Abroad in 1914.
($ millions at current exchange rates)

Regions	Europe	Western Offshoots	Latin America	Asia	Africa	Total
UK	1219	8254	3682	2873	2373	18311
France	5250	386	1158	830	1023	8647
Germany	2979	1000	905	238	476	5598
Other	3377	632	996	1913	779	7700
USA	709	900	1649	246	13	3514
Total	13444	11173	8390	6100	4664	43770

Source: Maddison, A. (2006) p.101. Other = Belgium, Netherlands, Portugal, Russia, Sweden, Switzerland, and Japan.

6 Pollard, S. (1985).
7 ibid. p. 490.

This very short overview of some of the trends in the major economic indicators of the more integrated world economy that arose in the 1870-1914 period does, however, require elaboration. Analogies are often drawn between this first modern globalization and the current globalization that came to the forefront after the fall of communism in Eastern Europe and the disintegration of the Soviet Union. A large part of this literature portrays the current globalization as a return to the liberal order that existed in the pre-1914 period.[8] The underlying characteristic of this period, according to this literature, is that technological advances, especially in transportation and communications, and low tariffs led to a sharp increase in exports and rising trade shares. Along with this, resource endowments led to the specialization of trade in raw materials from Africa and Asia and deepened the North-South trade dimension through the closer integration of Latin America. The gold standard enabled the mobility of capital, which flowed where there were opportunities for higher profits. Capital flows complemented trade and raised trade flows to a higher level, thus giving a further impetus to integration. Industrialization was spreading through the periphery of Europe and parts of Latin America. Export growth in the raw material exporting countries led to a certain trend in convergence (catching up), as they were experiencing higher growth than the developed countries. This world came to an end through the political factors that ignited World War I, which buried the liberal order and gave rise to communism as an alternative, taking globalization off the agenda for more than half a century.

This idyllic view of the integrated international economy finds some roots in the picture that Keynes painted in his *Economic Consequences of the Peace* published in 1920:

"The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages; or he could decide to couple the security of his fortunes with the good faith of the townspeople of any substantial municipality in any continent that fancy or information might recommend. He could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality, could dispatch his servant to the neighbouring office of a bank for such supply of the precious metals as might seem convenient and could then proceed abroad to foreign quarters without knowledge of their religion, language or customs, bearing coined wealth upon his person and would consider himself greatly aggrieved and much surprised at the least interference."[9]

---

8 Sachs, J. and Warner, A. (1995). This paper is an example of this type of literature.

9 Keynes, J.M., (1920), pp.9-10.

In Keynes's analysis of the pre-war period one can actually see the virtuous circle at work. Greater productivity leads to larger populations, larger markets, increased immigration – in short to a rise in demand for industrial and capital goods from overseas. This leads to further industrialization, which, accompanied by a gold standard, leads to a rise in foreign trade and foreign investment. The combined effect is higher interdependence and a further stimulus to growth, fuelled by the further expansion of industrialization and rises in productivity. In this world all is fine and well, provided that these processes continue on and on, never coming to an abrupt stop.

Another element of the international system at the time, which Keynes found to be of outstanding importance for the preservation of the growth model just described, was the reliance on the import of cheap foodstuffs from overseas, primarily from the United States. The import of foodstuffs on favourable terms enabled Europe not only to sustain a growing population, but also - since foodstuffs constituted an important element of the wage bill - to maintain the stability of its social arrangements. Cheap foodstuffs made European exports competitive. Keynes thought that this feature of the global system was already coming to an end with rising prices of foodstuffs and that there would have been major shifts in the world economy had war not broken out.

Furthermore, Keynes saw that this whole system rested on maximizing capital accumulation. What this actually meant in his description of the globalization of his time was that high income inequality, with the upper classes' higher propensities to save, made possible the rise of fixed capital that created the foundation for growth. This would never have occurred in a social setting with a more equitable distribution of income and depended on the pacification of class conflict. The latter was basically achieved through what he called "bluff" (ideological spin, in today's jargon).

In his own words: "I seek only to point out that the principle of accumulation based on inequality was a vital part of the pre-war order of Society and of progress as we then understood it and to emphasize that this principle depended on unstable psychological conditions which may be impossible to re-create. It was not natural for a population, of whom so few enjoyed the comforts of life, to accumulate so hugely. The war has disclosed the possibility of consumption to all and the vanity of subsistence to many. Thus the bluff is discovered: the labouring classes may be no longer willing to forgo so largely, and the capitalist classes, no longer confident of the future, may seek to enjoy more fully their liberties of consumption so long as they last and thus precipitate the hour of their confiscation."[10]

This picture is obviously less idyllic than those that portray the pre-1914 period in the light of a positive advocacy of the present globalization. Still, there remain some issues that need to be addressed and clarified more thoroughly.

---

[10] Keynes, J.M., (1920), p. 19.

Table 3. Tariff protection 1875 and 1913 percent

Countries	Average duties on manufactured goods		All Products
	1875	1913	1913
Austria-Hungary	15-20	18-20	18-23
France	12-15	20-21	18-24
Germany	4-6	13	12-17
Italy	8-10	18-20	17-25
Russia	15-20	84	73
United States	40-50	44	33
Spain	15-20	34-41	37
United Kingdom	0	0	0

Source: Bairoch, P. and Kozul-Wright, R. (1996), p.8

The first issue relates to the portrayal of the 1870-1914 period as an almost universal free trade regime with low tariffs being the dominant attribute of the trading system. This simply does not stand up to scrutiny. It is true that free trade was dominant in Britain throughout the period and that some other nations followed this policy (Belgium, Netherlands, Switzerland), but the true era of Europe-wide free trade lasted only for the two decades between 1860 and 1880 with the coming into effect of the Anglo-French Treaty. Following the Civil War the United States had adopted a protectionist policy through lobbying for infant industry protection. The beginning of the end of the free trade era in Europe began with the German election of 1878, which brought in a protectionist majority. The raising of tariffs slowly spread and was basically the result of coalitions between agriculture and industry, with the agricultural interests being disappointed by their inability to compete with cheap grains from North America. Although free trade was imposed by Britain on its trading partners in Latin America, some of these states, most importantly Brazil raised their import duties. These developments are illustrated in Table 3.

The second issue is the concentration not only of investment but of trade. As already noted, almost half of all foreign direct investment can be ascribed to Britain. Trade basically took a similar pattern. Close to two-thirds of world trade belonged to Europe with around 40% of total world trade being intra-European trade. Close to two-thirds of foreign trade was in primary products, the number rising to three-quarters if we add the United States.[11]

Another feature that stands in stark contrast to the current liberal advocacy of the diminished role of the state in the current globalization is the huge role that the state played among the latecomers to industrialization, as described by Ger-

[11] Kenwood and Lougheed, (1994) pp.80-81

shenkron.[12] In the European context this is especially true of Germany and Russia. More importantly, the state was much more involved in the process of technological change through support of the development of railways and communications. These sectors had strong links with the steel industry and later the electrical power industry. Furthermore, the direct involvement of the state in the economy was caused by the perceived need to strengthen military capabilities. Indeed, in the period before World War I the seeds of a more or less state-sponsored military industrial complex were sown.

Closely related to the new technologies was the rise of the financial sector (banking and stock exchanges) that went hand in hand with the rise of the large corporations and monopolies. Indeed, this was most visible in the United States during the "robber baron" period and was accompanied by very inequitable income distribution. The other country were this was most visible was Germany, in which the large banks sprang up along with the *Konzern* (Large Firms) in the process of rapid industrialization. These phenomena were a direct consequence of the need for higher capital formation in order to pursue rapid industrialization based on the new technologies. This required state involvement in institutional change in various areas. In short, the state became more involved in the economy than in previous periods.

Industrialization, which brought some convergence in per capita income, also had deep social and political consequences in the pre-war period. The first was the changing character of politics with the democratization of European societies. The period was marked by reforms that extended the franchise to broader strata of the populations throughout Europe against the background of general strikes and protests and in the wake of the Paris Commune of 1871. In Britain the Reform Act of 1883 quadrupled the electorate bringing it up from 8% to 29% of men over the age of twenty. In Belgium the electorate was extended from 3.9% to 37.3%, in Norway from 16.6% (and similarly in Sweden) to 34.8%, and in Austria-Hungary 50% of the male population acquired the vote in 1907.[13] This permanently changed the character of politics through the introduction of mass political parties and a new style of campaigning. Needless to say, with socialist movements on the rise the involvement of the masses in politics bred fear in the ruling classes and led to devious ways of curbing the powers of parliament or the part of parliament elected by universal suffrage. The most striking example of this was the Bismarkian model that minimized the constitutional rights of parliament. Nevertheless, the introduction of mass politics brought new pressures on the ruling elites both from the right and left of the political spectrum and further brought the phenomenon of rising nationalism into politics in an unprecedented way.

[12] Gershenkron, A. (1952)

[13] Hobsbawn, E. (1989), pp. 85-86.

Finally, the period from 1870-1913 was the period of a scramble for imperial expansion, during which the greater part of Africa and the rest of the world that had not been taken up to that point was carved up. These nations were dragged into the world economy at gunpoint and through all sorts of atrocities, including mass murder. In the case of the Belgian Congo mass murder bordered on genocide (a word that came into existence after 1945) with estimates of 10 million slaughtered, raising an outcry even at the time of high imperialism and racism. True, India was already ruled by the British Empire, as were some other nations, but in the observed period there was a frenzy of colonial expansion, most probably driven by a fear that the world was after all finite and that imperial ambitions would be left unsatisfied if action was postponed.

At the pinnacle of this global system was Great Britain, although somewhat losing its dominant position. It had the largest empire, "on which the sun never sets", and the largest navy and merchant navy. It was the largest foreign investor, London being the centre of world finance and insurance. It was still an industrial powerhouse and still the first in manufacturing on a per capita basis. It made up for its trade deficits through income from its investments abroad. Its currency was on the gold standard and the dominant world reserve currency. In short, this whole period between the Congress of Vienna (1815) and the outbreak of World War I (1914) was the Pax Britannica. In other words, Britain was the hegemon in the full sense of the word. In the latter part it compensated the loss of its dominant position in some crucial areas (manufacturing, control of the seas) through other means (diplomacy, finance, investments). Here we define hegemony as the dominant position in the international order that enables the hegemon to set the important rules of conduct for the actors in international relations and enforce them either through various forms of coercion, or more often the threat of coercion.

How were all of these phenomena connected? Did globalization undermine the foundation of the prevailing international order and bring on its own demise? Why was the period of technological progress and prosperity also a period of the expansion of empires on a world scale? Was there something in the international economic and political order that worked systematically towards world war or was the armed conflict the result of bad decisions by the political and military leadership of what were then called the Great Powers? Indeed, how can the period be discussed at all without taking into account the imperialistic nature of the epoch? Theories of imperialism tried to answer these basic questions and it is to them that we now turn.

Before that, let us first try to summarize some of the identified characteristics of the period of the first globalization from the perspective of the identification of the economic trends, major economic actors, internal political phenomena, and main characteristics of international relations. These are listed in the following Table 4 and represent a very broad outline.

Table 4. The Western nations and their offshoots (1870-1914)

Economy - high growth rates	Economic actors and factors	Internal Politics	International relations
Growth of GDP, population, GDP/ capita	Major technological innovation Gold standard Free trade - later rise in protectionism	Growing democratization –extension of franchise	Shifting Alliances Wrong perceptions of war Perceptions of world as finite economic space – zero sum game
Growth of foreign trade	Monopolies Corporations, *Konzerns*, Trusts	Change in nature of politics - elections – demagoguery	Rise of new regional powers
Growth of foreign investment	Growing role of state in the economy	Mass social movements - rise of labour	Colonial expansion – Imperialism
Growth of immigration	Growing role of banks and finance	Rise in income inequality	Expansion of Military role
Growth of productivity	Dominance and growth of industry	Rise of nationalism and rising fear of socialism	Britain as hegemon Rivalry for spheres of influence
Growing demand after 1890s	Growing power of new economic elites	New legitimacy-linked to delivery	Prestige and distrust of others

3. THEORIES OF IMPERIALISM

When discussing the theories of imperialism we must first make two very broad divisions. The first one divides those that see imperialism primarily as a consequence of and in the end determined by economic necessity and those that see it as a remnant of the past and not fundamentally stemming from the economic system of capitalism This would classify some prominent authors, most notably Josef Schumpeter and Hannah Arendt in the second group.[14] The second division would then divide the 'economic' explanations of imperialism into the non-Marxist and Marxist theoretical camps, the most notable among the first being Hobson[15] and among the second Luxemburg, Hilferding, Lenin, and Bukharin[16]. Finally, there is the third large group that would claim Marxist origins and would constitute what I would most broadly define as the school of Neo-imperialism[17], and whose theoret-

[14] Schumpeter, J (1951, original 1919), Arendt, H. (1968)

[15] Hobson J (1972, original 1902)

[16] Lenin, V. (1999, original 1916), Bukharin, N. (1972a, original 1915), Luxemburg, R. (2003, original 1913), Hilferding R, (1981, original 1910).

[17] This would include Paul Baran (1957) considered as the founder of a part of the structural dependency school that considers itself Marxist. The modes of production school and the theories of unequal exchange of Marxist origin belong to different types of theorizing within this tradition.

ical work reached its peak in the 1970s and 1980s and which will be discussed in brief later. Since this paper is dedicated to the relationship between the economic causes of imperialism, the theories that put major emphasis on the non-economic roots of imperialism will not be considered. Also, it should also be noted that Hobson, Hilferding, and Luxemburg published their analysis of imperialism before the outbreak of war, while Lenin and Bukharin wrote their works during the war years.

Obviously, among the authors that share the general view that there were systematic underlying causes of imperialism, there are disagreements concerning the nature of the causation. The other area of disagreement lies in the sphere of prediction, that is, the future not only of the imperial powers but also of the colonies. Bearing this in mind, I will try to clarify the position of the authors on these two major themes of a) the causes of imperialism and b) the future development of the colonies.

Hobson, being the most prominent from the non-Marxist camp and the first to highlight the economic roots of imperialism, deserves to be in a category of his own. For reasons of space, one cannot do justice to his works. A summary will therefore be short and mostly addressed to the two major points of interest.

The gist of Hobson's analysis is that it is the capitalist investor who is the prime mover of imperialistic expansion due to a highly inequitable distribution of income that sets a limit on consumption, i.e., there is an endemic lack of profitable investment opportunities. Thus, under-consumption is the source of an aggressive search for profits through investments abroad, which in turn gives the impetus for imperial conquest. According to Hobson, these traits of the capitalist system could be remedied through a rise of purchasing power in the population at large. Alternatively, the other solution is a correction of the system through a substantial redistribution of what he calls the social product, in order to provide profitable investment through the rise in demand that would result from a more equitable distribution of income.[18]

The vast difference between Hobson and the classical Marxist theory of imperialism (Luxemburg, Hilferding, Bukharin, and Lenin) lies in his belief that tendencies to imperialism were not inherent in the capitalist system as such, but were the product of the outdated social and political system of Britain. Thus, imperialism is the product of what would today be called state capture by the aristocratic classes for the pursuit of their own private interests. It follows that reform of the system is possible through political engagement and that a return to a more competitive system would make the system more democratic by giving voice to the economic interests of the broader strata of the population. Maintaining such an equitable and democratic society would, however, require permanent oversight by the state and

[18] It should be noted that in Chapter 22 of *The General Theory of Employment, Interest and Money*, Keynes discusses Hobson's work at some length and compliments him for the courage to take on orthodoxy from the methodological perspective that focuses on under-consumption , although he highlights the differences between his theory and that of Hobson. Keynes, J. M. (2008) (original 1936).

its institutions. In other words, Hobson was a reformist with a liberal democratic angle to his critique of imperialism. This brought him close to Schumpeter. Still, his work was influential, not least because Lenin relied on his study extensively.

Hobson was very pessimistic when considering the effects of imperialism in the colonies and the colonies' future. In fact, he was more sceptical of the "modernizing" or "developmental" potential of imperialism than was the classical Marxist theory of imperialism. Some of his statements could easily find resonance in statements made at a much later date by authors associated with *dependency* theory. The following paragraph is characteristic of his general conclusion:

"The condition of the white rulers of these lower races is quite parasitic; they live upon these natives, their chief work being that of organizing native labour for their support. The normal state of such a country is one in which the more fertile lands and the mineral resources are owned by white aliens and worked by natives under their direction, primarily for their gain: they do not identify themselves with the interests of the country or its people, but remain an alien body of the sojourners, a "parasite" upon the carcass of the "host" destined to extract wealth from the country and retiring to consume it at home."[19]

His evaluation of British Rule in India is devastating: "A century of British rule, then, conducted with sound ability and goodwill had not materially assisted to ward off the chronic enemy, starvation, from the mass of the people. Nor can it be maintained that the new industrialism of machinery and factories, which we have introduced, is civilizing India, or even adding much to her material prosperity."[20]

The paradox is that the classical Marxist theory of imperialism, in spite of descriptions of imperialist destruction of indigenous nations and their economic systems, showed greater optimism concerning the future of the colonies and the positive transformative role of capitalism. This, no doubt, stems from the dominant reading of Marx's theory of social change as an inevitable evolutionary process from lower to higher social formations. Furthermore, Marx and Engels were among the first authors to describe the process of capitalist expansion and globalization with teleological optimism:

"The need of a constantly expanding market for its products chases the bourgeoisie over the whole surface of the globe. It must nestle everywhere, settle everywhere, and establish connections everywhere… It compels all nations, on pain of extinction, to adopt the bourgeois mode of production; it compels them to introduce what it calls civilization into their midst, i.e., to become bourgeois themselves. In one word, it creates a world after its own image."[21]

It is not my intention to dwell here on the various interpretations of Marx, but a more complex interpretation can be posited that shows greater ambivalence

---

[19] Hobson, J. (1972) pp.282.
[20] Ibid. pp. 288-289.
[21] Marx and Engels (1969, original 1848) p.39.

towards the consequences of world-wide capitalist expansion, yet preserves coherence through the use of Marx's theoretical constructs.[22] Be that as it may, the classical Marxist theory of imperialism stood by the then mainstream interpretation of Marxism that portrayed capitalism as a dominant force for development of what would later be called the Third World. Nevertheless, in their works passages appear that strain their dominant theorizing and conclusions. In other words, there seems to be room for the reconstruction of a certain ambivalence concerning the future of the colonies in the writings of the classical Marxist theorists of imperialism that lingers in the background of their otherwise optimistic view of the development of the colonies.

This is most obvious in the work of Rosa Luxemburg, who shares with Hobson the under-consumptionist approach in identifying the fundamental cause of imperialism. She is the only author of the classical Marxist theory of imperialism that tried to develop an explanation of imperialism explicitly along these lines. Luxemburg, however, was taking a different theoretical conceptualization of the problem than Hobson by trying, through a critique of Marx and his use of reproduction schemes, to establish a proof of the systematic inability of the capitalist system to consume its surplus, thus necessitating an outlet in foreign investment. Furthermore, the inability to reproduce itself in a closed system led to imperialism and the need for the exploitation of pre-capitalist societies in order to enable the accumulation of capital and the survival of the system itself.

This line of reasoning came under attack on both technical and theoretical grounds by prominent Marxists such as Otto Bauer, provoking Luxemburg to respond at length[23]. Later, after her death, Bukharin was her most thorough critic.[24] In a nutshell, the criticism boils down to technical mistakes made in the use of reproduction schemes and the prediction of the mechanical breakdown of capitalism after the conquest and integration of the colonies into the capitalist mode of production. The latter really implies that capitalism cannot exist as an economic system independently of the colonies or other pre-capitalist modes of production. Furthermore, what the Marxists found to be disturbing at the time was the potential long lease of life of capitalism that Luxemburg was implying through her theory, although she herself thought that the end of capitalism would come much sooner through socialist revolution.

For the purpose of this paper, however, two aspects of *The Accumulation of Capital* are important. One is the recognition of militarism and the rise of the military industry within the advanced capitalist countries as a means to divert surplus from the non-capitalist strata. This theme of militarism and the military-industrial complex, along with under-consumption, would be taken up later by Marxists and

[22] Vujačić, I. (1988).
[23] Luxemburg, R. (1972 original 1915)
[24] Bukharin N. (1972b original 1924)

remains a recurring theme to this day. In a striking passage, Luxemburg almost predicts the coming catastrophe:

"The more ruthlessly capitalism, by means of militarism sets about the destruction of non-capitalist strata at home and in the outside world, the more it lowers the standard of living for the workers as a whole, the greater the effects on the day-to-day history of capital accumulation on the world stage. It becomes a string of political and social disasters and convulsions, and under these conditions, punctuated by periodical economic catastrophes or crisis, accumulation can go on no longer."[25]

The contribution of Luxemburg's work to more modern Marxist themes is the interaction of the capitalist mode of production with the heterogeneous pre-capitalist modes of production through their subjugation or destruction by imperialism. These themes will reappear in the neo-Marxist articulation of the modes of production school in the 1980s. There is an extensive analysis in Luxemburg's work of the penetration of capitalism in India, China, the USA, Algeria, Turkey, Egypt, and Persia that can inspire this type of theorizing. Simultaneously, certain passages remind the modern reader of the imperial forces at work in creating a "comprador" class:

"The British government employed precisely the opposite tactics. For a long time it appeared as the protector of the natives, flattering the chieftains in particular, it supported their authority and tried to make them claim a right of disposal of their land. Wherever it was possible it gave them ownership over tribal land, according to well tried methods, although this flew in the face of tradition and the actual social organization of the Negroes."[26]

Luxemburg also had a negative view of international loans, describing them as leading to what in today's terms would be called a debt trap: "Heavy war contributions necessitated a public debt, China taking up European loans, resulting in European control over her finances and occupation of her fortifications; the opening of free ports was enforced, railway concessions to European capitalists extorted. By all these measures commodity exchange was fostered in China, from the early thirties of the last century until the beginning of the Chinese revolution." [27]

Consider the following description of Egypt's loans in light of later debt issues in the Third World: "These operations of capital, at first sight, seem to reach the height of madness. One loan followed hard on the other, the interest on old loans was defrayed by new loans, and capital borrowed from the British and French paid for the large orders placed with British and French industrial capital...While the whole of Europe sighed and shrugged its shoulders at Ismail's crazy economy, European capital was in fact doing business in Egypt on a unique and fantastic scale—an

[25] Luxemburg, R. (2003), p. 447.
[26] Ibid. pp. 393-394.
[27] Ibid. p. 367.

incredible modern version of the biblical legend about the fat kine which remains unparalleled in capitalist history."[28]

A more optimistic view of the effects of capitalism in the colonies was expounded by Hilferding. Writing in 1910, he saw capitalism as developing the colonies to a point that would lead to their emancipation. His optimism concerning this is in tune with the later-developed modernization theory of western sociologists:

"At the same time the competition for the newly opened spheres of investment produces further clashes and conflicts among the advanced capitalist states themselves. In the newly opened countries themselves, however, the introduction of capitalism intensifies contradictions and arouses growing resistance to the invaders among the people, whose national consciousness has been awakened, which can easily take the form of policies inimical to foreign capital. The old social relations are completely revolutionized, the age-old bondage to the soil of "the nations without a history" is disrupted and they are swept into the capitalist maelstrom. Capitalism itself gradually provides the subjected peoples with the ways and means for their own liberation."[29]

Hilferding's real contribution to the Marxist theory of imperialism had more to do with his analysis of the rise of monopolies and the role of finance capital. Some latter-day Marxists would object that although he was an astute observer of the development of capitalism in Germany he was making a broad generalization that could not be easily applied to other countries. Be that as it may, Hilferding described a world of cartels, trusts, conglomerates, and *konzerns* that due to large investment needs came under the dominance of the banks. The interlocking directories so present at the time created a certain symbiosis of banks and industry that Hilferding dubbed "finance capital". The monopolistic basis of finance capital causes its opposition to laissez-faire capitalism. Thus it seeks and gets protection from the state through tariffs and other policies. A powerful state is also, according to Hilferding, a much-needed instrument for asserting the interests of finance capital abroad through pressuring smaller states into favourable treaties and through the expansion of colonies. The export of capital was important for obtaining higher rates of profit. Foreign investment was also stabilizing, since it made monopolies under "finance capital" less vulnerable to economic downturns. According to this vision, a more organized state-backed monopolistic capitalism was expanding throughout the world through competition with other states and the acquisition of colonies. This imperialist drive was being ideologically justified through nationalism and racism. It would be a very short step to a war with rival imperial powers. In fact Hilferding predicted the outbreak of world war and revolution:

"The ideal now is to secure for one's own nation the domination of the world, unbounded by the capitalist lust of profit from which it springs. Capital becomes

[28] Ibid. p.414.

[29] Hilferding, R. (1981) p. 322.

the conqueror of the world, and with every new country that it conquers there are new frontiers to be crossed" [30] writes Hilferding, and adds at the very end, " At the same time it (finance capital) makes the dictatorship of the capitalist lords of one country increasingly incompatible with the capitalist interests of other countries, and the internal domination of capital increasingly irreconcilable with the interests of the mass of the people, exploited by finance capital but also summoned into battle against it. In the violent clash of these hostile interests the magnates of capital will finally be transformed into the dictatorship of the proletariat".[31]

Hilferding's and Hobson's work was extensively used by Bukharin and Lenin, with the latter's *Imperialism* later canonized in Marxist orthodoxy. In fact there was not much that was original in Lenin's work and this created some confusion, as pointed out by Brewer.[32] A totally opposite view was expounded by Kemp, who qualifies the work as one that "despite its lack of completeness...comes nearest to being a full and satisfactory treatment of the subject".[33]

Before getting somewhat into this controversy and further elaboration, Lenin's famous five characteristics that define imperialism deserve to be quoted in full:

"1. The concentration of production and capital has developed to such a high stage that it has created monopolies which play a decisive role in economic life; 2. The merging of bank capital with industrial capital, and the creation, on the basis of this "finance capital", of a financial oligarchy; 3.The export of capital as distinguished from the export of commodities acquires special importance; 4.The formation of monopolistic capitalist associations that share the world among themselves; 5. The territorial division of the whole world among biggest capitalist powers is completed."[34]

Leaving aside the scholastic controversy of whether Lenin subtitled his work as the Last, Latest, or Highest Stage of Capitalism (*Highest* is the official translation), what Lenin certainly did was to define imperialism as a distinct phase in the development of capitalism. In short, imperialism, according to Lenin, is a manifestation of monopoly capitalism, as a new phase in the development of capitalism itself. This has certain theoretical implications that I will not dwell on here. Secondly, throughout the work he stresses, as all true Marxists would, the unevenness of capitalist development. Finally, he stresses inherent conflict concerning the division of colonies between advanced capitalist states as "natural" to monopoly capitalism itself. This final point stems from the fact that Lenin wrote *Imperialism* to a large extent as a polemic against Kautsky, a prominent leader in the German socialist movement, who had put forth his thesis on "ultra-imperialism" under which there

[30] Ibid. p. 335.
[31] Ibid. p. 369.
[32] Brewer, A. (1990)
[33] Kemp, T (1967), p. 85.
[34] Lenin, V. (1999) p. 92.

would arise a peaceful accommodation between the advanced capitalist nations in carving up and jointly governing the world.

In terms of his five characteristics themselves, it is easy to see that the first two were directly taken from Hilferding. Concerning the third point, it is not clear where the causation lies in terms of the prevailing Marxist theory of the time. There are passages that seem to follow the Hobson argument of under-consumption while in others it seems that the export of capital acts as a counterforce to the tendency of falling rate of profit. The following passage shows his ambivalence regarding this, although it looks like he gets close to the Hobson under-consumption argument:

"As long as capitalism remains what it is, surplus capital will be utilized not for the purpose of raising the standard of living of the masses in a given country, for this would mean a decline in profits for the capitalists, but for the purpose of increasing profits by exporting capital to the backward countries…The need to export capital arises from the fact that in a few countries capitalism has become "overripe" and (owing to the backward stage of agriculture and the poverty of the masses) capital cannot find a field for "profitable" investment".[35]

On top of that he sees this imperialistic phase as one in which monopoly capitalism can dampen class conflict through the exploitation of the colonies by providing higher wages to the working class in the home countries and thus forming a labour aristocracy. He describes the possibility of whole nations becoming "usurer states" and "rentier" states living of their foreign possessions. This also brings him close to Hobson, whom he cites, but also backs up with references to Engels. The labour aristocracy issue should be seen in the light of the failure of the Second International, that is the labour movement, to prevent the war. In spite of all this, he predicted the downfall of capitalism in the advanced countries.

Lenin was pretty straightforward concerning the future of the colonies in regards to the necessity of capitalist development as a prerequisite for socialist revolution. After all, it was he who did a whole study on *The Development of Capitalism in Russia*[36] (albeit much earlier) as a polemic against the Narodniks who were arguing for the possibility of bypassing capitalism as a phase in development. They ascribed the lack of conditions for the development of capitalism in Russia to the lack of a deep enough domestic market due to mass poverty, i.e., under-consumption. This should make us cautious about branding Lenin as an under-consumption theorist.

Ironically, it was Lenin who triggered a socialist revolution in what Marxists saw as a backward country and who would later advocate self-determination for the colonies as an ideological weapon against imperialism.

The work of Bukharin had, for various reasons, been neglected and was therefore not as influential. Bukharin also drew largely on Hilferding, and his analysis is

[35] Ibid pp. 70-71.
[36] Lenin, V. (1977, original 1899).

close to that of Lenin. He did stress the contradictions between the growing "internationalization" and the "nationalization" of capital, that is, between the growing interdependence of the world economy and the division of capital into national blocs. Like the others, Bukharin also described the position of the colonies in terms that would later look to be in accord with neo-Marxist dependency theory, such as in the following passages:

"The cleavage between "town and country" as well as the "development of this cleavage", formerly confined to one country only, are now being reproduced on a tremendously enlarged basis. Viewed from this standpoint entire countries appear today as "towns", namely, the industrial countries, whereas entire agrarian territories appear to be "country". [37] Or, "It follows that world capitalism, the world system of production, assumes in our time the following aspect: a few consolidated, organized economic bodies ("the great civilized powers") on the one hand, and a periphery of underdeveloped countries with a semi-agrarian economy on the other".[38]

It is difficult to summarize and do justice to the literature of what is often called the classic theories of imperialism. Still, given the purpose of this paper, in Table 5 I have tried to point to what I consider to be their basic features.

Of course, the analysis and argumentation in these works are much more complex and have inspired numerous interpretations. There are four major features of these theories that I feel need to be highlighted.

1. They all link imperialism with capitalism and its perceived inherent economic logic i.e., its inability to constructively absorb its economic 'surplus'.
2. They all point to the contradictions between globalization (capitalist expansion) and rivalry between imperial states.
3. The Marxist versions describe the negative socioeconomic aspects of colonial rule, but predict their capitalist development over time.
4. The Marxist version sees war among imperial powers as a natural outcome and considers socialist revolution as both a consequence and the only remedy for imperialism.

Although somewhat mechanical and simplified, these theories attempt to provide causation and coherence. The empirical evidence, however, runs contrary to some of the cruder hypotheses that can be derived from them, or is extremely flimsy at best. For example, the data on Britain as the supreme imperialist state before 1914 shows, as already noted, that there was a net inflow instead of net outflow of capital in regards to foreign direct investment, as opposed to what one would expect to be the case on the basis of the theories of imperialism just discussed.[39] Furthermore, by far the largest part of total foreign investment was portfolio invest-

[37] Bukharin, N. (1972a) p.21
[38] Ibid. p.74.
[39] Pollard, S (1985) pp. 489-514.

Table 5. Classic Theories of Imperialism

Author	Causes	Predictions	Remedies	Effects on Colonies
Hobson	Under-consumption – non-Marxist	New political movements	Democratic capitalism, redistribution of income	Imperial parasitism – no development for host country
Luxemburg	Under-consumption – reinterpretation of Marx Schemes of reproduction	Militarism and Nationalism Crisis, Convulsions, War	Socialist revolution	Destruction and articulation of modes of production
Hilferding	Falling rate of profit – monopoly and finance unite to organize state capitalism	Militarism and Nationalism and War	Socialist revolution	Development leads to emancipation
Lenin	Finance capital and imperialism firmly linked Division of the world into colonies by leading capitalist states – need to invest surplus - Labour aristocracy	War both now and later is inevitable –leads to downfall of capitalism Imperialist rivalry not cooperation	Socialist revolution	Capitalism is an inevitable phase
Bukharin	State capitalism vs. internationalization of capital	War is expression of capitalist contradiction	Socialist revolution	Capitalism is an inevitable phase

ment - loans to governments, public utilities, and for infrastructure. Direct foreign investment went mostly into the exploitation of raw materials in the colonies.[40]

In spite of the fact that these theories can be easily criticized on both theoretical and empirical grounds, their effort to explain the reasons for the outbreak of the 'Great War' on grounds that linked imperial rivalry and expansion directly to economic interests is still valuable. Put another way, the theories that seek to divorce economic interests and imperial expansion from policy by finding causation for the latter in purely political, military, or diplomatic factors seem to be even more lacking. In the words of Michael Barrett Brown, "One is bound to ask what was the object of Indian security, of French control over Algeria, in the United States' "manifest destiny" in the Western Hemisphere, if they did not provide markets for goods, sources of raw materials and opportunities for investment under privileged

[40] For more detailed data see Michael Barratt Brown, (1976)

conditions?"[41] As Hobsbawm put it: "The attempt to devise a purely non-economic explanation of the 'new imperialism' is as unrealistic as the attempt to devise a purely non-economic explanation of the rise of the working class parties".[42]

The perceived necessity of expansion for linked economic and political reasons was widespread among the ruling elites. Seeing the world as finite and economics as a zero sum game certainly boosted the drive to imperial expansion and strengthened belligerent and militaristic attitudes. An additional factor contributing to this view must have been the slow but sure rise of protectionism, which might have led to the belief that creating potential markets with imperial preferences was one sure way to ensure economic growth in the long run. As the British Prime Minister, Robert Cecil, said to the French Ambassador in 1897: "If you were not such persistent protectionists, you would not find us so keen to annex territories". [43]

Furthermore, factions of the elites saw imperialism as one potential answer to possible internal political upheaval or radicalization of demands by the new politically organized masses and social movements. For example, Cecil Rhodes was quite explicit when he observed: "In order to save forty million inhabitants of the United Kingdom from a bloody civil war our colonial statesman must acquire new lands for settling the surplus population of this country, to provide new markets… the Empire as I have always said is a bread and butter question".[44]

Nowhere were internal political reasons and the drive for outward colonial expansion so closely linked as in Germany. Indeed, unification and rapid latecomer industrialization induced social strains and demands on the state to provide stability. Colonialism was seen as one way to stabilize the economy and to pacify potential internal political and class conflict.[45] In fact the analysis of the French ambassador to Berlin in 1884 sounds likes a line out of the Marxist theory of imperialism: "Industrial development in Germany which has resulted in overproduction drives Germany to seek the acquisition of colonies".[46]

In Germany there was also a strong sentiment that it had been left out of the dividing-up of the world and that this would prevent it from taking its rightful place among other nations, as proclaimed at the turn of the century (and echoed by others) by Heinrich von Trietscke, a historian and politician:

"Up to the present Germany has always had too small a share of the spoils in the partition of non-European territories among the powers of Europe, and yet our existence as a state of the first rank is vitally affected by the question whether we can become a power beyond our seas. If not there remains the appalling prospect of England and Russia dividing the world between them, and in such a case it is hard

[41] Barratt Brown, M. (1976). p.193.
[42] Hobsbawm, E. (1989) p. 69.
[43] Hobsbawm, E. (1989), p. 67.
[44] Hobsbawm, E. (1989) p. 69.
[45] Wehler, H. (1972)
[46] Ibid p.80.

to say whether the Russian knout or the English money-bags would be the more immoral and frightful alternative."[47]

Sentiments of this nature were present all over the continent, and even the United States came into the game late, through its expansion acquiring its largest protectorate in the Philippines. Great power status, nationalism, and racism all combined to support imperial expansion. Expansion also had a military dimension, in the sense that some conquests were made not out of economic need but to geographically ensure other more important colonies or trade routes.

The result was World War I and its aftermath. The consequences were grave, three empires fell, new states were created in Europe and the Middle East, Britain ceased to be the financial centre of the world, and communists created the first socialist state (USSR). Yet in spite of these and other serious and deep changes, from the vantage point of our subject the world remained remarkably the same.

The victorious imperial powers retained their colonies, with the only new states outside of Europe formed in the Middle East. The USSR was effectively isolated from the rest of the world. The United States emerged as the leading world economy and the world financial centre, but did not take over the role of hegemon, instead going back into isolationism. The Gold Standard was reintroduced and trade and foreign investment picked up. Globalization was recovering and it looked like the old order had been restored. The 'new' Great Depression put an end to that through the abolition of the Gold Standard, the rise in protectionism, and the collapse of the financial sector. Dire economic times also brought to Europe the totalitarian ideologies of Fascism and Nazism, based on racism and rabid nationalism as somewhat modified features of the pre-World War I imperialism.

This set of historical circumstances rekindled the old imperial drive for colonization (Italy) and territorial expansion (Germany) as a way of achieving status in a world still based on imperialism. Actually, the whole period from 1914-1945 can be observed in continuity as a thirty years war, with the same causes. After all, the two decades in the interwar period have been described by no less a historian than E. H. Carr, as the twenty-year crisis.[48]

Depending on the methodology used, all divisions into historical periods can be viewed as somewhat arbitrary. From the point of view of the theories of imperialism discussed in this paper, the continuity of the interwar period is logically founded. Not only that, but the Marxist theories of imperialism continued to be a guide in policy-making for the leadership of the USSR and the Communist International, both affecting and being used for the legitimization of adopted policies. The Soviet Union's rapid industrialization was to a large extent legitimized by the context of potential imperial conflict that could embroil or, worse, would be aimed at the Soviet Union. In 1931 Stalin gave a speech on rapid industrialization in which he

[47] Quoted in Mommsen W. (1982) p. 5.
[48] Carr, E. H. (2001, original 1939)

spoke of the necessity of catching up with the advanced countries for purposes of defence. He closed it with the following words: “We are fifty or a hundred years behind the advanced countries. We must make good this distance in ten years. Either we do it, or we shall be crushed”.[49] He was led to this conclusion by both foreign intervention in the civil war after the October revolution and Marxist theories of imperialism.

Furthermore, one has to remember that before and immediately after coming to power the Bolsheviks had as a matter of principle supported national liberation movements and parties, and advocated alliances between these political actors and the communist parties while acknowledging the necessity of the capitalist phase of development. However, after the Soviet Union was isolated, its defence as the first and only socialist state was seen to be of prime political and ideological importance, not just for the Bolsheviks but for the Communist International (Comintern) as well. Along with the new doctrine of “socialism in one country” and skipping the phase of capitalist development previously thought to be necessary before the introduction of socialism, the Bolsheviks both instrumentalized and radicalized the Comintern. Therefore, in accord with developments in and the needs of the Soviet Union, but also to mobilize the communist parties in the colonies for the struggle against imperialism by infusing them with energy and self-confidence, the Comintern adopted a new approach. In 1928 at its Sixth Congress it adopted a resolution that basically negated the progressive role of capitalism in the colonies.[50] This conclusion obviously departs from Marx and other classical Marxist authors and would be theoretically elaborated after World War II.

4. THE COLD WAR AND THE RISE OF THE THIRD WORLD

The period between 1945 and 1989 saw dramatic changes in regards to our subject of inquiry. After World War II the Western countries were integrated through cooperation, planning, NATO, and the Marshall plan. This integration led to the establishment of the European Union and its ever broadening and deepening integration. During this time (in the 1950s and early 1960s), economic growth in the West as well as in the Eastern bloc and Japan was staggering, and is considered to be a golden age of economic development that was never repeated. World trade grew even more than GDP and foreign investment was picking up. All of this was happening under the umbrella of the Bretton Woods system of fixed exchange rates and capital controls, whose very success led to its demise in 1971. The United States became the hegemon in the non-communist world. This period also saw a

[49] . Stalin., J. (1931) .
[50] Communist International (1928)

drive to decolonization, which took almost two decades after the end of World War II to be completed.

This was also a time of worldwide rivalry between the two systems. They competed not only on the superpower and technological levels, but also to impose their socio-economic and political systems as models that others, especially those in the third world, should aspire to. This period also opened a theoretical debate on the potential development of the Third World, i.e., which system would lead to faster growth, industrialization, and development, terms that at the time looked synonymous. Growth rates became a symbol of success and source of legitimacy for the Third World political elites.

During this period there arose competing theories of development and underdevelopment. One stemming from the ideological world view of the West became known as "the theory of modernization" and came in many forms. The other consisted of a structuralist and neo-Marxist approach and was explicitly anti-free market or anti-capitalist in nature and much more inclined to heavy state involvement and planning in the economy. Given that the newly established ex-colonies were weak and perceived as still dominated by the West, the terms "neo-colonialism" and "neo-imperialism" came into being to describe situations where formal sovereignty was considered insufficient for autonomous development due to various forms of dominance by the former imperial powers or the West in general. Thus there arose a whole school of dependency theory, both on neo-Marxist and non-Marxist lines, which tried to portray that capitalism along with the world market was an impediment to the development of the Third World. The authors that belong to the dependency school are many and their work is vast in scope, covering case studies of countries and various historical periods.

The origins of the dependency school can be traced to Latin American authors who belonged to the structuralist school (Prebisch, Singer, Furtado, Sunkel) and others, both non-Marxist and neo-Marxist, like Dos Santos and Cardoso.[51] The founding of the neo-Marxist branch of this type of theorizing has been ascribed to Baran (1957)[52], although credit should probably go to Fritz Sternberg, who a decade earlier had elaborated his views on imperialism as an impediment to development in the colonies.[53] Be that as it may, the central thesis was radicalized by Frank[54], who coined the phrase "development of underdevelopment", which points to capitalism not just as an impediment but as an active agent in fostering underdevelopment in the Third World. Other authors like Wallerstein,[55] who introduced

[51] The first were a group formed around CEPAL (UN Economic Commission for Latin America). Cardoso later renounced dependency and became president of Brazil (1995-2003).

[52] Baran, P. (1957)

[53] Sternberg, F. (1947) I thank the late Professor Daniel Fusfeld, University of Michigan, who pointed this out to me a long time ago.

[54] Frank, A. (1969)

[55] Wallerstein, I.

world-systems theory basically as a variant of dependency theory, have divorced the concept of imperialism as a 'new' phenomenon from modern capitalism itself by including the expansion of imperial trade in the 16th century under the same roof of modern day "imperialism" or "dependency".

Basically, dependency theory tried to demonstrate that the determining factor of underdevelopment, or at best limited development, lay in the relationship between the core (developed capitalist countries – metropolises) and periphery (underdeveloped non-communist countries). According to this theory the periphery countries' integration into the world economy is primarily initiated through and subservient to the interests of multinational corporations (MNCs). Foreign direct investment through MNCs affects the structure of the economy by creating a modern sector that is not really fully linked to the national economy and has low spill-over effects. This creates an upper and upper middle class that are linked to the modern sector or sectors related to it, thus aligning it to foreign interests and making it into, in the more radical jargon, a "comprador bourgeoisie". The unbalanced structure of the economy leads to lack of self-sustained growth and development and stifles technological progress that does not spread from the modern sector. This type of integration then forms state structures that are unable to foster balanced economic development. Dependence is thus perpetuated, creating a long-lasting structure that can only be overcome with difficulty. The softer versions of dependency allowed for potential development in the periphery but limited development within the parameters of the core-periphery relationship. The remedy was seen either in socialist revolution or state-sponsored autonomous industrialization through import substitution strategies, some of which were applied in Latin American countries and thought to be partly successful. Even so, import substitution strategies according to the more radical dependency theorists, may reinforce dependence.

Dependency theory dominated the discourse on development through the mid-1980s and produced interesting case studies and empirical tests of certain major hypotheses. The problem that arose, however, was conceptual. Dependency theory was criticized for the tautological definition of dependency as its central category. In other words, dependent countries are dependent because they are dependent (due to historical circumstances) and cannot break out of this vicious circle that is enforced through the core-periphery relationship. This conceptual framework does not allow for making significant distinctions between the heterogeneous economic development of countries, in spite of the introduction of categories such as 'semi-periphery' or 'sub-satellites' by dependency theorists. In other words, the dependency approach does not allow for an analysis of the dynamics of development that takes into consideration the deeper transformation of internal structures that enable rapid development in certain countries. From the perspective of some Marxist critics, the identification of capitalism with integration into the world market emptied the concept of capitalism of its true meaning of a social relationship between free labour and capital. This in turn prevented the analysis of the class dynamics that breed different paths of development.[56] Alternatively, a whole new Modes of Production school of Marxist inquiry tried to explain the diversification of development experiences through the articulation of various pre-capitalist and capitalist modes of production and how they affect the internal development of countries once integrated into the world market.[57] More traditional Marxists such as Warren saw imperialism, in the phrase of one author, as the "pioneer of capitalism" that would lead to the development and emancipation of these nations according to the traditional reading of Marx. Basically, Warren[58] accused the Marxist dependency approach of straying from Marx both theoretically and by ignoring data that according to his interpretation was showing rapid development of at least parts of the Third World. Needless to say, this also sparked controversy.

Actually, the widespread popularity of dependency theory was to a large extent associated with disappointment with development performance in the Third World. This should not have been such a surprise, given the structure of the world economy at the outbreak of World War II. At that point, approximately 70% of all manufacturing was concentrated in only five countries and 90% in just eleven countries. The core absorbed four-fifths of the periphery's primary products, while two-thirds of all manufactured products were sold to the periphery.[59] Given that decolonization began after 1945 and took two decades to complete, in retrospect it seems unrealistic to have expected that the high growth rates of the core and socialist bloc could have spread to the new countries. The core-periphery relationship was the best description of the structure of the world economy at least up until the 1980s and to a large extent it can still apply today, as a description of the relative stagnation of the developing countries in relation to the advanced capitalist core. Suffice it to say that the share of the developed nations (the USSR included at the time) in world manufacturing, a major indicator of development, was 88% in 1980.[60] At the time, industrial countries amounted for 63% of all foreign investment inflows with 27% going to the developing countries.[61]

With the growth of trade and foreign direct and portfolio investment, a Triad consisting of North America, the European Union, and Japan was being formed, representing the core of the world economy with high interaction between these major players. Looking at the flows of foreign direct investment (inward and outward) at the beginning of the new millennium, Europe accounted for over 50% of inward and 60% of outward, North America around 22% of both, and West and

[56] Brenner, R, (1977), Laclau,E (1971)
[57] Foster-Carter, A. (1979), Hindess, B. and Hirst, P. (1975)
[58] Warren, B. (1980), Lipietz, A.(1982)
[59] Dicken, P. (2007), p. 34.
[60] Bairoch, P. (1982) p. 296 and p. 304.
[61] World Bank (1985) p.126

South East Asia for slightly above 10% in both categories. This added up to almost all outward investment and around 86% of inward investment.[62] In other words, certain structural characteristics remained to a great degree intact.

Nevertheless, processes were at work that were fundamentally changing this structure. First there was the rise of the 'Asian tigers' and the market-oriented reforms introduced in China. Then the collapse of communism in Eastern Europe along with the demise of the Soviet Union itself opened the door to a new era of the world economy.

5. THE NEW GLOBALIZATION - ANY RELEVANT ANALOGIES?

With the demise of the Soviet Union and the reforms in China that integrated it into the world market, we arrived at the era of the world economy most often described as globalization. This concept is generally used to signify an ever-growing interdependence in almost all spheres of life, a process rather than a state that feeds on itself, leading to faster and higher levels of interaction of various phenomena and\or actors on the global scale. The broadness of this ad hoc definition, similar to a great deal of other definitions of globalization, is really on closer inspection void of theoretical content. This makes its use both easy and widespread.

The question that really arises is the real content of this term. More to the point, is it not the capitalism of free trade, free capital movement, easy withdrawal, financial deregulation and the like, that is assumed to be the content of globalization? Is not the concept then used as a vantage point from which we evaluate the chances of economic success through the level of a country's openness to "globalization"? Do we not then use this term to reinterpret history by naming the period of high imperialism before World War I as the "first modern globalization"? In other words, could it be possible to define globalization in Marxist terms as a phase of higher level "neo-imperialism" a concept which itself stems from the older definition of classical "imperialism"? I use the term globalization without quotation marks throughout this paper, but the reader has been warned of the limitations of the concept. Globalization in the economic sphere I take to basically mean the described ever-rising free market flows on a global scale.

It can certainly be claimed that the period of the new globalization defined as the post-1989 period, i.e., post-communist, has seen a dramatic rise in foreign trade and foreign direct investment. Total world merchandise exports reached 18.3 trillion (US) dollars, while total exports of commercial services reached 4.6 trillion dollars. All in all, total exports reached close to 23 trillion dollars in 2013.[63] This is

[62] Calculated from WTO (2005) World Trade Report and World Bank (2005) World Development Indicators.

[63] WTO (2014J) p. 1.

around 30% of world GDP, a level reached in 2008 and regained after a drop due to the financial crisis. This is a significant increase compared to the pre-World War I level that was first matched in the 1970s and then surpassed in the 1990s. This period has also seen a rise of merchandise exports from the BRICS (Brazil, Russia, India, China, and South Africa), which have taken a larger share of merchandise exports on a global scale, reaching 18.5% of total merchandise trade. This, however, masks the fact that China's share alone is 12.1% and that the rest adds up to 6.4%. Obviously the rise of China, the previously named "Asian tigers", and other new rising economies like India, Malaysia, and Thailand, demands a new definition of the Triad. Including all of them into the category of Asia along with Japan could be useful for some purposes.

Thus, the share of each region's exports in total world merchandise exports has dramatically changed (with the exception of Europe) since the end of World War II, as illustrated in Table 6.[64]

Table 6. Share of Region in World Merchandise Exports

Year// Region	North America	South & Central America	Europe	Com. Independent States	Middle East	Africa	Asia
1948	28.1	11.4	35.1	2.2	2.0	7.3	14.0
2013	13.2	4.0	36.3	4.3	7.4	3.3	31.5

However, what can also be seen is that there is a high concentration of trade within the trading blocs of the Triad. This is illustrated in Table 7.

Table 7. Share of each region's exports of world merchandise exports within the region 2013[a]

Region	North America	Europe	Asia
North America	38.6	5.5	9.2
Europe	16.4	68.4	12.3
Asia	32.6	12.8	56.7

[a] Ibid. p. 25.

This trade structure has been relatively constant over a long period, with regional trade taking precedence. That closeness and size play a big role, as depicted in gravity models, goes without saying. They are also the result of trading blocs like the EU and NAFTA (North American Free Trade Agreement). However, in more recent times there are additional factors at work that tend to make for extra barriers to more broadly based free trade. With the lack of success in tariff reductions during the Doha round there has been a proliferation of regional trade agreements

[64] Ibid. p. 26.

(RTAS) that threaten to undermine the multilateralism that had served so well in promoting trade during the post-World War II period. There is obviously a tendency to create mega-regional trade agreements that will probably undermine the WTO, rather than be an impetus for broadening them and thus making them more multilateral. The most obvious examples are the negotiations on the Trans-Pacific Partnership (TPP) led by the United States and the Transatlantic Trade and Investment Partnership (TTIP) that is currently being negotiated between the United States and the EU. These are threatening to change the architecture of world trade. In the Pacific, the TTP includes North America, Chile, Peru, and a number of leading Asian economies, but not China. Simultaneously, China is conducting negotiations on the Regional Comprehensive Economic Partnership (RCEP), which would include Asian countries but not the United States. This is just an illustration of the conflicting interests, needs, and concepts of how the major economic players see free trade. The United States is more interested in 'behind the border' issues such as technical and safety standards and the treatment of foreign investors, while countries like China are more interested in tariff reduction.

During this wave of globalization there has also been a rise in foreign direct investment. Foreign direct investment stock amounted to around 10% of world GDP in 1913 and did not reach that level again until around 1989, while reaching 30% in 2009. In terms of annual flows, foreign direct investment stood at 2.5% of world GDP in 1913, reached that level again in 1999, and went up to 4% in 2007 just before the 2008 crisis. It then returned to 2.5% in 2011.[65] Taking into account all foreign investment assets (by adding bonds and equity) would produce a very similar picture, with these assets reaching 50% of GDP in countries in the sample in 1913, attaining that level again only around the year 2000, and shooting up to around 150% in 2012.[66] The big difference is that the developing countries have recently become the major hosts for foreign direct investment, a position that the EU held for a long time. Needless to say, too much should not be made of this, since a large part goes to China.

In spite of gains, in the Third World there is generally still has a deep divide between core and periphery. The World Bank's more differentiated classification of countries into low-income economies, lower and upper-middle economies, and high-income economies does reflect differentiation in the Third World. It also mixes some of the transition economies with the developing countries, which can lead to confusion. However, in spite of the rising share of the developing countries in world GDP, from 25% to 37%[67] in the past two decades, the growth in GDP has mostly been concentrated in the rising Asian economies (especially China), as has the growth in GDP per capita. Not surprisingly, the share of the developing

[65] Subramanian, A., Kessler, M. (2013) p.7
[66] MGI, (2013), p. 26
[67] Calculated from World Bank figures for 2011 at market exchange rates.

countries in world trade has also risen, to 38% in 2008,[68] and the growth is again concentrated in Asia. With these figures the developing countries have regained the shares in world GDP and trade that they held in the pre-1914 period. The same type of concentration is visible when it comes to direct foreign investment. The top ten and top five developing countries take up respectively around two-thirds and over half of the share of the developing world's GDP, exports, and inward foreign direct investment stocks and flows.[69] Furthermore, some countries may be exhibiting what is called the "middle-income trap", not being able to rise above a certain level and join the higher income-per-capita group.

What have, then, been the major changes in the world economy, and how do they compare with the pre-1914 era? A summary of these trends is presented in Table 8.

The financial crisis also reaffirmed a model that is different from the liberal competitive market model of capitalism. This is the model of state capitalism. For the purposes of this paper, I define state capitalism as a system in which there is

Table 8. The Recovery of Globalization in Trade, Investment and Developing Countries position

Phenomena/ Year			
World Merchandise Trade as percent of World GDP	1913 17	1978 17	2010 26
Stock of Foreign Direct Investment	1913 10% of World GDP	1989 10% of World GDP	2009 30% of World GDP
Stock of Foreign Investment (equity plus bonds)	1913 50% of GDP of countries in sample	2000 50% of GDP of countries in sample	2012 150% of GDP of countries in sample
Annual flow of Foreign Direct Investment	1913 2.5% of World GDP	2007 4 % of World GDP	2011 2.5% of World GDP
Developing countries share in world GDP	1913 37%	Highly concentrated in top ten countries	2011 37%
Developing countries share in world trade	1913 38%	Highly concentrated in top ten countries	2008 38%
Rise of MNC's	1913 Many of these companies founded during first globalization	1945- 1989 Rise of multinationals that number 70 000 in 2010	2011 1/3 of World Trade, 1/2 of World Foreign Direct Investment

[68] UNCTAD (2013) p. 27

[69] Calculated from World Bank (2005) and UNCTAD (1994, 2005)

strong state ownership in enterprises that are competing in markets with profit as their primary goal. This leaves out more traditional state-owned enterprises such as airlines, railways, public transportation companies, utilities and the like. More recently, aside of Russia and China, state capitalism has been used as a term to describe the economic system of some of the other larger dynamic economies such as Brazil and South Africa. These countries had appeared to have weathered the storm of the crisis somewhat more successfully than others and have become a model to emulate in some developing countries. One should keep in mind that the Western free-market system was far from totally innocent in this regard, given that Western countries host the largest and dominant multinational corporations (MNCs). Some of these MNCs are a direct outgrowth of the original large firms that arose in the period of the first modern globalization. The close relationship between these firms and the state in modern capitalism strongly resembles the characteristics described in the classical literature on imperialism. If we add that there are estimates that MNCs account for at least 30% of world trade and at least half of all foreign direct investment, the resemblance to the pre-1914 world becomes more pronounced.

The latest crisis has provoked a rise in non-tariff barriers to trade and a reintroduction of regional trade blocs through regional trade arrangements. It has also brought back some capital controls as an answer to huge drops in cross-border finance in the aftermath of the financial crisis. This has brought state intervention back in a way that differs from the pre-crisis period when the free-market philosophy of the Western countries dominated and was buttressed by the "Great Moderation", characterized by low inflation, low unemployment, and absence of large downturns. The "Great Moderation" was the economists' version of the end of history, implying that high major volatility of the economy was a thing of the past.

In the US there has been a decline in merchandise exports and rise in imports, and a fall in its share of FDI, which accounted for 50% of all FDI in the 1960s and is now at 21%.[70] This has gone hand in hand with a rise in inward FDI, making it almost equal to outward FDI. This is somewhat analogous to the erosion of Britain's position regarding manufacturing on the eve of World War I. It would be wrong to interpret this as the beginning of the decline of the United States, just as it is wrong to interpret the position of Britain at the end of the belle époque as one of decline. It was not natural for Britain to retain its position in manufacturing, given the industrialization of the United States and other latecomers to industrialization. It did maintain its predominance in terms of finance, banking, insurance, trade, and both the navy and merchant navy, making it still firmly the hegemon. The position of the United States is similar, in the sense that it is in a position of hegemony in all the mentioned spheres, with the manufacturing sector being less important today than before.

[70] Dicken, P. (2007), p. 42.

In Europe the most striking feature is the formation of the EU, its positive expansion, and the formation of the monetary union. Of course, the process in the various EU countries has been uneven. The latest crisis has emphasized the rise of Germany as the dominant economic and political actor in the Eurozone. It is also, just as on the eve of World War I, the major economic partner to most Eastern, Central European and South Eastern European countries and the most successful of the large European economies. This puts it into a leadership position within the European Union in spite of its reluctance to assume this role, a position that will only be accentuated if Britain decides to leave the European Union. Given that the institutional reforms needed to strengthen the Eurozone and the probable rise of circles of various levels of further European integration, Germany will by default come to dominate the economic policies of the 19 countries that make up the Eurozone (including France) at least in the medium term. This will probably create political conflict and tensions (witness the Greek crisis), but these should be mitigated by the strong integration of the European economies and the benefits of the European Union, the common market being the most obvious. One should, however, bear in mind that before World War I the economies of Europe were very much intertwined, as was the interaction with major Western Offshoots.

In Asia we have seen the new rise of Japan (which had become a major power before 1914) and the 'four tigers', the re-emergence of China, and the new dynamism of India. Finally, we have seen the emergence of the transition economies of Eastern Europe, which have not yet made a difference in the global scheme of things but have huge potential for future growth.

A newer aspect of the world economy is the rise of the role of finance, which is more integrated on a global scale than ever. Financialization, as it has been called, is definitely a new feature that has been under the spotlight in discussions on the world economy since the 2008 crisis. The scope of this paper prohibits an analysis of this subject. Let it just be said in passing that the link between financialization and the crisis has very much strengthened the idea of state capitalism and the curbing of finance through strong regulation.

In international relations some analogies with the pre-1914 period come to mind. The first is the obvious hegemony of the United States, a position similar to that of Britain pre-1914. The loss of its share of manufacturing in the world economy and the rise of manufacturing in other fast-growing regional powers is another similar trait that, as has already been said, should not be interpreted as an erosion of the hegemonic position of the United States. The rise of China as a regional power with territorial disputes on its borders and potentially conflicting interests with the United States and Japan in the Pacific may resemble some of Germany's uneasy relationships with the European Great Powers at the time of its expanding economy before World War I. The build up of the Chinese navy is somewhat reminiscent of Germany's naval race with Britain before 1914.

Another similarity may lie in shifting alliances. The confrontation of the West with Russia over the Ukraine and the subsequent reaffirmation of NATO's role and its potential further expansion have created a major shift. It looks like efforts to integrate Russia with the West have failed and will not be rekindled until a lasting solution to the Ukrainian crisis is found. This is making Russia turn to China for deeper cooperation, not just for economic reasons. The potential alliance between a regional power on the rise (China) and a regional power that is facing internal and economic difficulties (Russia) could have some resemblance to the alliances of Germany and Austria-Hungary, and later Turkey, before World War I.

There can hardly be any close analogies to the scramble for raw materials during the period of colonial expansion. At that time Germany was seeking colonial expansion both for reasons of prestige and because the general perception was that the world had been carved up and there might arise a problem of access to markets and raw materials. And yet there is a distant resemblance with Chinese efforts to expand into the Third World in order to obtain raw materials and other resources on a long-term basis. This has been done with investment, loans to governments, and the acquisition of companies, and is backed up by diplomacy. In fact, the characteristics of Chinese expansion have prompted the label "the new colonialists".[71]

Finally, there is the issue of the perception of war. It was mentioned at the beginning of this paper that on the eve of World War I there was a perception that the war would be short and decisive, with much fewer casualties and destruction than was the case. Certainly, today the major military powers are aware of the potential consequences of war. Nevertheless, proxy wars, (for example by arming the Ukraine such as being advocated by many, most prominently Republican legislators in the United Sates) could lead to unforeseen escalation and consequences.

On the other hand, that the wrong perception of war can lead to the erosion of readiness to use military capabilities and greatly damage the international standing of a superpower can best be observed through the example of the consequences of the US-led wars in Afghanistan and Iraq. A situation like this could lead to the misinterpretation of superpower reaction (US) to actions taken by regional powers (Russia, China) which could lead to escalation of conflict with unforeseen results.

It is true that there is historical awareness that the first globalization ended in the unforeseen catastrophe of World War I and that according to some interpretations World War II was in many ways its continuation and certainly an even larger disaster in terms of its consequences. The fact that we live in a nuclear age in the minds of many reduces the likelihood of direct confrontation between the major powers that posses them. This is because it is logical to contend that in the nuclear age, the consequences of a nuclear war would be the end of the word, not metaphorically, but literary. One should remember, however, that this was also very well known by the leaderships of the two superpowers during the Cold war and that this

[71] *Economist* (March 15th, 2008 and Jan 17th, 2015)

did not stop them from bringing the world to the edge of annihilation at least once (and probably at other times that we know less about).

The argument that close economic ties help to soften potential conflict and mitigate political confrontation or at least breed an interest for compromise is certainly a valid one. Strong economic ties and interests can certainly be the counterweight to vast ideological and political differences and can help to rebalance relations among potentially hostile actors. It should not be forgotten, however, that economic ties among major powers were quite strong not just in regards to trade but also investment on the eve of World War I. In fact, basing his central thesis on the analysis of these intertwined economic interests that were a product of the first globalization, Norman Angell published a book called *The Great Illusion*, in 1910. In it he argued that war between the Great powers was impossible since dominant economic ties and common interests and mutual benefits that are the result of deep economic interaction would be the decisive factors that would prevent it from occurring.[72] He was proven wrong just four years later. There are other instances in history when economic interest should have prevailed and prevented conflict and war. In short, the end of the first globalization should remind us that the downfall of the new globalization is not impossible and that there is no underlying factor that makes its sustainability inevitable. Another major crash of financial markets due to a new bubble on Wall Street, the disintegration of the European Union through the unravelling of the Eurozone or Britain's exit, a major recession in China, a major disruption of oil supply caused by widespread war in the Middle East, any one of these or their combination could lead to a series of events that might put an end to the new globalization as we know it.

I wish to summarize by pointing out certain analogies between the pre-1914 world and the current globalization. These are presented in Table 9, where I have bolded the differences between it and Table 4, which was used to describe the characteristics of the first modern globalization. Analogies exist and should not come as a surprise as our world is largely shaped by the economic and political factors that defined the first globalization. They are worth noting, but one should also remember that analogies point not only to similarities but also to differences that are far from negligible.

Finally, current theorizing on imperialism by Marxist authors needs to be mentioned. As noted, the classical Marxist theories of imperialism saw it as linked to the very nature of capitalism in its monopolistic stage. Monopoly capitalism was inherently flawed creating the problem of underconsumption and fall in rate of profit. The consequence was a drive to imperial expansion that enabled nations, sections of society, and monopolistic firms to invest profitably. This in turn led to a division of the world, conflict, and finally world war.

[72] Angell, N. (1911)

Table 9. The first and the current globalization

Economy	Economic actors	Internal Politics	International relations
Growth of GDP, population, GDP/ capita **(population decline in EU)**	Corporations **Multinationals Transnational enterprises** dominate trade and FDI	Growing **disappointment** in **democracy**	Shifting Alliances (**Russia, China)** Wrong perceptions of war (**US Iraq, Syria)**
Growth of foreign trade	Major technological innovation	Change in nature of politics - elections **Tea Party in US, EU populism**	Rise of new regional powers **(EU, China, India, Russia) New Trade blocs being formed**
Growth of foreign investment	Growing role of state in the economy	Weak social movements - fall of labour	New Colonial behaviour – China raw materials
Growth of immigration	Growing role of banks and finance **Finacialization**	Rise in income inequality	Expansion of Military (**US, China, Russia)**
Growth of productivity	Dominance and growth of industry	Rise of nationalism	**USA as hegemon** Rivalry for spheres of influence
Stagnation in EU after 2008	Growing power of new economic elites and **new major players in world economy**	New legitimacy-lacking	Prestige and distrust of others (**China, US, Russia)**

To a large extent Marxist authors still see the absorption of surplus under monopoly as the driving force behind imperialism. Certainly, Paul Baran (1957) who co-authored with Paul Sweezy *Monopoly Capital* (1966) the indispensible work of the neo-Marxist approach to modern capitalism did.

As already mentioned, with decolonization and the rise of the Third World, various currents of dependency theory including world systems theory saw capitalism as at least a direct obstacle to development, due to the structure of core-periphery relationships in the world economy. The emphasis on Third World development actually shifted the focus of analysis away from the centre of the world economy, that is, from the analysis of the dynamics of capitalism in the centre of the world system and its link to imperialism as in the classical Marxist works on imperialism. Another major feature of the dependency (world systems) approach is the primacy of exchange relations and surplus extraction of various sorts (trade, unequal exchange, multinational company behaviour, etc.) between the centre and periphery. Some of these theorists (Amin) explicitly saw the new contradiction between labour and capital and the socialist revolution as elevated to the world level between capitalist core states and the "proletarian" periphery states. This came under attack by some Marxists who emphasized the primacy of production and not exchange as a necessary methodological starting point of analysis of centre –periphery relations. Others reverted back to the classical Marxist position that stresses progressive the developmental role of capitalism. A whole school of thought launched the modes of production controversy to explain the variation in capitalist development in the periphery. By the late 1980s dependency theory had gone by the wayside.

With the downfall of communism and the Soviet Union and the fast-growing literature on globalization, new types of theorizing on imperialism within the Marxist tradition have emerged. All of these inquiries try to include the interaction between political and economic factors in their analyses. A great deal of this theorizing still revolves around the law of accumulation of capital and the expression given to this law in various historical periods. Suffice it to say that Marxist theories of imperialism and explanations concerning the world economy or international relations come from a competing paradigm that makes dialogue with other paradigms (neoclassical theory in economics, the rational actor school in political science, realist or idealist schools of international relations theory) extremely difficult, and practically impossible. The new theoretical approaches are not easy to classify. I will nevertheless attempt to do so at a certain risk.

Lacking the conflict induced by inter-imperialist rivalry after World War II, as predicted by the classical theories of imperialism, there was a certain revival of the position of Karl Kautsky who originally argued that a cooperation between imperialist powers based on monopoly capitalism is conceivable. The lack of deeper rivalry between what would be called imperial powers, that is core developed capitalist countries could be easily explained for the period of superpower and ideological competition between the USSR and the US as the leaders of the two opposed camps. This long post-war period, the rise of multinational corporations and the higher levels of globalization led to the rise of theorizing that gave primacy to the ascent of transnational capitalism.

All neo-Marxist theorizing on imperialism and/or globalization recognize the rise of transnational institutions, transnational corporations and transnational elites. Where they differ is the place they give them in relation to nation states and the way in which they see and depict their interaction. Those that give primacy to the transnational level argue that transnational structures and the transnational capitalist class are changing nations states both by subjecting them to external "rules of conduct" as well as by embedding transnational structures within them.[73] The most radical version, far above the transnational approach, is promoted by Hardt and Negri,[74] who claim that capitalism is an international entity that dominates

[73] Robinson, W. (2004)

[74] Hardt, M , Negri, A. (2000)

through rules and structures and has risen above particular states. It has acquired an international sovereignty which they simply call "Empire". In this postmodern version neither the "centre" of the world economy nor imperialism exist anymore. At the same time, they depict "Empire" as a three tier system with nation states in all three and the "multitude" (masses) at the bottom. This makes their conceptualization somewhat contradictory. Nevertheless, this radical transnational thesis had rekindled the debate among neo-Marxist theorists of imperialism.

Among these, Harvey and Callinicos[75] stress continuity with the original Marxist concept of imperialism, emphasizing the division of the world into the Triad, with significant conflicts of interests between the major trading blocs and with others (China, Russia). In other words, these authors stress the potential inter-imperialist rivalry of the classical theories of imperialism.

Another neo-Marxist view sees rise of globalization as a transnational form of capitalism, with the United States taking the leading role in enforcing rules that benefit transnational elites. According to Pantich and Gindin,[76] the global capitalist system was created through the conscious efforts of the ruling elites of the United States. Efforts in this sense were made since the beginning of the twentieth century and have culminated success. The United States as the leading imperialist nation, however, often takes a broader view of the interests of global capitalism rather than pursuing solely its own economic interests. Nevertheless, there is a contradiction between the capacity of the United States to support global capitalism and the capacity of other core states to keep balance between consumerism and the welfare state on the one hand and austerity measures on the other against the background of increasing inequality. According to this view the financial sector has taken the leading role in fostering global capitalism and remains major potential factor of instability.

This short summary is a very rude depiction of an otherwise broad literature. Needless to say, many others with interesting insights have been omitted here given the scope of this paper. The intention is to point out that neo-Marxist theories of imperialism are present and heterogeneous. These newer theories of imperialism have had various focuses and have highlighted different aspects of the world economic and geo-political structures. They stem from the classical Marxist theories of imperialism that were the result of an effort to creatively interpret Marxism in a new historical context of monopoly capital, the scramble for colonies and militarism at the times of World War I. In that sense, there is a certain continuity between the authors of the classical Marxist theories and authors of the newer neo-Marxist school. Both stress the link between capitalism and forms of dominance of the world market (empire and colonies, centre and periphery). Both stress exploitation of the non-capitalist world through its integration with capitalism and

[75] Harvey, D. (2003) Callinicos, A. (2009)
[76] Pantich, L. Gindin, S. (2013)

the world market (colonial exploitation unequal exchange, dependency). Both see the dialectic between national and international capital as producing new forms of capitalism on a world scale. Where they differ is in assessing the developmental potential of capitalism for the Third world and the perceived existence of "inter-imperialist" cooperation or rivalry.

The fall of communism in Eastern Europe and the integration of China into the world market through foreign direct investment and multinationals, have dampened the left wing revolutionary aspirations of neo-Marxist scholars of imperialism. For a long time, their hopes were linked with Third world revolutionary movements that would in their view, liberate a large part of humanity from capitalist exploitation, lead to development on socialist and import-substitution foundations and be backed by the socialist countries that had remained true to their revolutionary creed (Cuba, China, Vietnam, Algiers, etc.). This led to the refocus of analysis back to the interaction among the core capitalist countries, emerging markets and geo-political issues. In fact, this can be seen as a return to the focus of analysis of the Classical Marxist theories of imperialism. Thus, we are able to find one more analogy between the current neo-Marxist theoretical approach and that of the Marxist theoretical preoccupations of the World War I period.

It is not easy to make a short summary of the neo-Marxist theories of imperialism. Nevertheless, I have tried to do so in Table 10.

The contemporary world seems so different from the one of a hundred years ago. And yet many of its features were formed during what has been called the first globalization that preceded World War I. Among these is the rise of the world market, the rise of new regional powers, the rise of economic interaction between nations on an unprecedented scale in terms of foreign direct investment and trade and many more. No wonder that there is so much interest in the analogies between the first globalization and the current one.

The sudden demise of the first globalization is ample reason to study it with the hope that the world can avoid a similar disaster. It is difficult to suppose that large military conflict that would put an end to globalization such as the one that occurred in WWI is even remotely likely today. As was already mentioned the major actors would be aware of the catastrophic consequences. What is conceivable, however, is that another major financial or economic crisis on a scale similar to (or larger than) the one in 2008 could bring it about. Another possibility is a major ecological disaster or a worldwide pandemic. There are other possibilities like massive migrations that can destabilize wide regions. All in all, the new globalization needs tending to with a major improvement on the level of global governance. Only then can we rest assured that the detrimental aspects of the new globalization that need to be mitigated will not overshadow the great improvement in the lot of mankind that it has brought about.

Table 10. A Summary of neo-Marxist Theories of Imperialism

Neo-Marxist theories of imperialism	Main causes and drivers of imperialism	Main consequences for the dominant capitalist countries	Main consequences for the periphery capitalist countries	Remedies
Baran and Sweezy	Problem of surplus absorption under monopoly capitalism	Surplus used in wasteful industries and military build up fostering imperialist tendencies	Victim of imperialism, exploitation and surplus extraction	Socialist revolution – planning and import substitution
Dependency Theory World System Theory	Various – surplus absorption, need for accumulation on world scale Unequal exchange	Not analyzed	Dependent underdevelopment, Dependent development	Socialist revolution – planning and /or import substitution
Classical Marxist criticism- Warren	Same drivers as in classical Marxist theory	Expansion of capitalism in the world	Some countries sooner, some later experience development	The capitalist phase is a condition for development after which socialism possible
Modes of Production School	Same drivers as in classical Marxist theory	Interaction and linking between capitalist and pre-capitalist modes of production	Development possible or underdevelopment perpetuated depending on modes of production articulation	Capitalism can develop periphery or hinder its development.
Newer neo-Marxist Theorizing on Imperialism				
Transnational Capitalism	Accumulation on a world scale	Transnational structures become dominant and compete between each other and nation states	US takes on role of champion of transnational capitalism. Militarism and intervention expand capitalism	Transnational competition will breed contradictions
Radical Transnational Theory (Hardt and Negri)	Accumulation on a world scale	International sovereignty of capitalism above nation states – called “Empire” has substituted imperialism and national capitalism. The world market rules the world.		Eventual revolt of the “multitudes” will make for transcendence of this order.
Revival of Classical Marxist Theory of Imperialism	Accumulation by disposition Harvey and Callincos	Dialectical interaction between economic and territorial (geopolitical) aspects of imperialism	Further expansion of capitalism in order to expand capitalism and enhance accumulation by disposition	Possible conflict among core capitalist /imperialist countries
United States as leading imperialist power	New role of finance leads to expansion of capitalist system on a world scale. The financial system is the core of global capitalism and the major factor of instability	The United States has become the dominant imperialist power through conscious design	The United States however plays a role of pursuing the interests of global capital, not just national	Contradiction between capacity of US and other core capitalist states to provide balance between consumerism and austerity and enable global capitalism

REFERENCES

Angell, N. (1910), *The Great Illusion*, Putman & Sons, London

Arendt, H. (1968), *Imperialism, Part Two of the Origins of Totalitarianism,* Harcourt Brace, New York.

Baran, P. (1957), *The Political Economy of Growth,* Monthly Review Press, New York.

Baran, P. and Sweezy P. (1966), *Monopoly Capital,* Monthly Review Press, New York.

Barratt Brown, M. (1976) *The Economics of Imperialism,* Penguin Books, Harmondsworth, Middlesex.

Biaroch, P. (1982). "International industrialization levels from 1750 to 1980", *The Journal of European History, 2,* pp. 269-333.

Bairoch, P. and Kozul-Wright, R. (1996), "Globalization Myths: Some Historical Reflections on Integration, Industrialization and Growth", UNCTAD discussion paper, 113, Geneva.

Brenner, R. (1977), "The Origins of Capitalist Development: A Critique of Neo-Smithian Marxism", *New Left Review*, 104, July-August. pp. 25-92.

Brewer, A. (2001, original 1980), *Marxist Theories of Imperialism – A Critical Survey*, Taylor and Francis, London and New York.

Bukharin, N. (1972a, original 1915), *Imperialism and World Economy*, Merlin Press, London.

Bukharin, N. (1972b, original 1924), *Imperialism and the Accumulation of Capital*, Monthly Review Press, New York.

Callinicos, A. (2009), *Imperialism and Global Political Economy*, Polity Press, Cambridge.

Carr, E. H. (2001, original 1939), *The Twenty Year Crisis*, Palgrave, London

Clark. C. (2013), *The Sleepwalkers: How Europe Went to War in 1914,* Harper, New York.

Communist International 6th Congress (1928), *Theses on the Revolutionary Movement in the Colonies and Semi-Colonies,* http://www.revolutionarydemocracy.org/archive/ColNatQ6.htm

Dicken, P. (2007), *Global Shift – Mapping the Changing Contours of the World Economy*, Guilford Press, New York.

Economist (March 15th, 2008) – Special report "The New Colonialists- China's Quest for Resources"

Economist (Jan 17th, 2015) - "China in Africa – One among Many".

Foster-Carter, A. (1978), "The Modes of Production Controversy", *New Left Review,* 107, January- February, pp. 47-77.

Frank, A. (1969, original 1967), *Capitalism and underdevelopment in Latin America*, Modern Reader Paperbacks, New York.

Gershenkron, A. (1952) "Economic Backwardness in Historical Perspective" Bert Hoselitz (editor) *The Progress of Underdeveloped Areas*, University of Chicago Press, Chicago.

Hardt, M., Negri, A. (2000), *Empire*, Harvard University Press, London.

Harvey, D. (2003), *The New Imperialism***,** Oxford University Press, Oxford.

Hastings, M. (2013), *Catastrophe 1914: Europe Goes to War,* Knopf, New York.

Hilferding, R. (1981, original 1910), *Finance Capital,* Routledge and Kegan Paul, London.

Hindess, B., Hirst, P. (1975), *Pre-Capitalist Modes of Production,* Routledge and Kegan Paul, London.

Hobsbawn, E. (1989), *The Age of Empire*, Vintage Books, New York

Hobson, J. (1972, original 1902), *Imperialism*, University of Michigan Press, Ann Arbor.

Kenwood G., Lougheed, A. (1994), *The Growth of the International Economy 1829-1990,* Routledge, London.

Kemp, T. (1967), *Theories of Imperialism*, Dobson Books, London.

Keynes, J.M. (1920), *The Economic Consequences of the Peace*, Macmillan, London.

Keynes, J.M. (2008, original 1936), *The General Theory of Employment, Interest and Money*, BNPublishing, London.

Laclau, E. (1971), "Feudalism and Capitalism in Latin America", *New Left Review, 67, May-June.*

Lenin, V. (1999 original 1916), *Imperialism –the Highest Stage of Capitalism,* Resistance Books, Sydney.

Lenin, V. (1977, original 1899) *The Development of Capitalism in Russia*, Progress Publishers, Moscow.

Lipietz, A. (1982), "Marx or Rostow?" *New Left Review, 132, March- April. pp. 48-58.*

Luxemburg, R. (2003, original 1913), *The Accumulation of Capital*, Routledge and Kegan Paul, London

Luxemburg, R. (1972, original 1913) The *Accumulation of Capital: An Anti-Critique,* Monthly Review Press, London and New York.

MacMillan, M. (2013), *The War That Ended Peace: The Road to 1914,* Profile Books, London.

Maddison, A. (2006), *The World Economy, Volume 1 and Volume 2,* OECD Publishing.

Marx and Engels, (1969, original 1848) *Manifesto of the Communist Party* in Marx, Engels, Selected *Works, vol. 1*, New York,

McMeekin, S. (2014), *July 1914: Countdown to War,* Basic Books, London.

MGI, McKinsey Global Institute (2013), *Financial Globalization: Retreat or Reset?*

Mombauer, A. (2002), *The Origins of the First World War*, Pearson, New York.

Mommsen, W. (1982), *Theories of Imperialism,* University of Chicago Press, Chicago.

Robinson,W. (2004), *A theory of Global Capitalism*, Johns Hopkins University Press, Baltimore.

Pantich, L., Gindin, S. (2013), *The Making of Global Capitalism,* Verso, London

Pollard, S. (1985). "Capital Exports 1870-1914: Harmful or Beneficial?" *The Economic History Review,* vol. 38, no 4, pp. 489-514.

Sachs, J., Warner, A. (1995), "Economic Reform and the Process of Global Integration", *Brookings Papers on Economic Activity, 1.* pp. 1-118.

Schumpeter, J (1951, original 1919), *Imperialism and Social Classes*, Routledge, London.

Stalin. J. (1931) On Soviet Industrialization - Speech to Industrial Managers, February 1931, http://academic.shu.edu/russianhistory/index.php/Stalin_on_Rapid_Industrialization

Sternberg, F. (1947), *The Coming Crisis*, John Day, New York.

Subramanian, A., Kessler, M. (2013), "The Hyperglobalization of Trade and its Future" Working Paper no. 3 Global Citizen Foundation.

UNCTAD (2013), *World Trade and Development Report*, Geneva

Vujačič, Ivan (1988), "Marx and Engels on Development and Underdevelopment: the Restoration of a Certain Coherence", *History of Political Economy, vol. 20: 3. pp. 471 – 498.*

Wallerstein, I. (1974) *The Modern World System,* Academic Press, New York.

Warren, B. (1980), *Imperialism Pioneer of Capitalism*, Verso Press, London.

Wehler Ulrich Hans, (1972), "Industrial Growth and Early German Imperialism" in Owen, R. and Sutcliffe, B. (editors), *Studies in the Theory of Imp*erialism, Longman, London. pp. 71-90.

World Bank (1985), *World Development Report*, New York

WTO (2014), *International Trade Statistics*, WTO, Geneva.

Chapter 4

A Critical Appreciation of Schumpeter's Theory of Imperialism

Kosta Josifidis*
E-mail: josifidis@gmail.com

Alpar Lošonc**
E-mail: corna@eunet.rs

Abstract: The aim of this paper is to contextualize Joseph Schumpeter's theoretical position on the First World War and analyse the importance of his contribution to the understanding of the different consequences of the war. Firstly, Schumpeter's paper on imperialism throws light on his fundamental ideas and can be instrumental in understanding the important trends in his overall opus. In this respect, in spite of the focus on Schumpeter's thinking within the framework of World War I, the paper also occasionally considers his work originating in other historical periods. Secondly, his thematization of imperialism is a relevant contribution to the understanding of the course of World War I. The basis for understanding Schumpeter's argumentation is that World War I needs to be positioned within the perspective of imperialism, that is, that World War I can only be interpreted through the analysis of imperialism. The paper consists of three parts. The first part presents relevant positions Schumpeter held on imperialism. The second part contextualizes Schumpeter's contribution to the understanding of World War I through imperialism and compares this theory to other interpretations. In the third part we present our criticisms of Schumpeter.

Key Words: Imperialism, World War I, Capitalism, Economic Rationalism, Economic Interest

JEL CLASSIFICATION: N10, N40, F50, F54

1. IMPERIALISM AS A BASIS FOR EXPLAINING WORLD WAR I

Economists have interpreted World War I in many different ways. Many analysts believe that the enigmatic nature of this war (considered to be more enigmatic than WWII) is the cause of the many heterogeneous interpretations. It is therefore

* Department of European Economics: Faculty of Economics, University of Novi Sad
** Department of Social Sciences: Faculty of Technical Sciences, University of Novi Sad

understandable that Schumpeter, being an economist who carefully studied the dynamics of capitalism and an assiduous observer of historical events, could not remain indifferent. He did not write a political economy of war like Arthur Pigou,[1] nor did he discuss the issue of who would cover the cost of war in the way tackled by Jacob Winer[2] or Allyn A. Young,[3] but he left us a theory of imperialism which offers insight into the understanding of WWI. This is not the only work by Schumpeter relevant to WWI. We could also mention his paper on the crisis of the tax state (1918) which represents the incipience of fiscal sociology, but it is our opinion that his theory of imperialism is the most significant and that its level of generalization allows for the deduction of Schumpeter's other modes of thinking.

In spite of the fact that he was relatively young at the outbreak of WWI, Schumpeter had already made significant scientific breakthroughs, which indicate that he matured rapidly and had formed his characteristic views on the economy fairly early. We can trace significant antecedent lines of reasoning which enabled the development of his theory of imperialism. This primarily refers to his books, which show an author who is extremely conscious of methodology,[4] and to his theory in which he subtly describes his dynamic view of capitalism.[5] Finally, within the context of WWI we should also mention his practical work, as his relation to WWI was not only theoretical and contemplative. He participated in the Socialisation Commission in Berlin, whose chairman was Karl Kautsky, and later he also became a finance minister.[6]

Thus Schumpeter's ideas on imperialism should be placed in a wider context, in which the war plays an important role. However, he wrote on imperialism both before and after World War I: thus his theorizing about imperialism should be viewed as a paradigmatic work, which also illuminates his overall thinking on the development of capitalism. The reception of Schumpeter's paper on imperialism has been tortuous; periodically these reflections have been "virtually forgotten"[7] although today they are generally regarded as exceptional.

Schumpeter's reflections are frequently understood from the sociological perspective, i.e., as his 'sociological theory', but here we should exercise caution. First, Schumpeter is very clear that he has in mind an "economic explanation" that "ends up with economic factors". He is in fact critical of the analysis of "imperialism...as

[1] Pigou (1921).
[2] Viner (1920).
[3] Young (1926), pp. 1-13.
[4] For example, Weber (1908).
[5] Schumpeter (1912).
[6] Stolper, (1982), p.34. In relation to practical work it would be interesting to compare analogies and differences between Schumpeter and Keynes regarding the position of "civil servant and economist", see, Skidelsky (1983), p.295. In relation to the conflict between theory and practice with Schumpeter, see Tsuru, (1993) p.263-268.
[7] See Krause (2003), p.179.

the reflex of the interests of the capitalist upper stratum".[8] In other words, Schumpeter criticizes the instrumentalist understanding of imperialism but does not reject an economic interpretation. In fact we can argue that Schumpeter's ambition is to provide a complex account of imperialism. Second, in discussing Schumpeter's approach, his attempts at formulating economic sociology should be taken into consideration.

Therefore, let us consider Schumpeter's most relevant ideas regarding imperialism, which deal directly with the context of WWI. Schumpeter continues his pre-war reflections on imperialism, but also takes into consideration the course and effects of the First World War.

Imperialism has to be considered within the perspective of a) territorial expansion and b) aggressiveness. Probably the most famous of Schumpeter's claims relates to the determination of imperialism as the "objectless disposition on the part of a state to unlimited forcible expansion". This claim is a continuation of non-instrumental understanding[9] and should be interpreted as suggesting self-referential mechanisms: territorial expansion becomes an aim in itself, the war is waged to gain victory, domination is desired because of ruling and commanding. It is symptomatic that one of Schumpeter's students, Jack Hirschleifer,[10] suggests that economics should consider the "dark side of the force" as a constituent moment (to separate things: Hirschleifer's conclusion that "war is economics by other means" is no longer Schumpeter's). In fact Schumpeter suggests a change in the object of economics by focusing on a set of instruments of "imperialism", albeit with economic categories.

For Schumpeter the existence of "objectless" imperialism does not necessarily mean that there is always, unreservedly, a conflict between economic categories such as profit and power. Complex relations between profit and power are still being forged, for example in relation to immediate and mediate results. Therefore it is possible for profit and power to be in conflict "as regards the immediate results"; yet the practicing of power can indirectly produce higher levels of profit, particularly in periods of "buccaneering imperialism".[11] Schumpeter, let us reiterate, denies the possibility of explaining the "policy of imperialism" on the basis of "objective economic interest" or "concrete interest". Interest, and consequently, economic interest does not explain the existence of war. Even if we look for the interest, it does not lie in "concrete war aims".[12] Only indirectly can we come to the economic aspects of imperialism, and thus also of WWI.

[8] Schumpeter, (1966), p.6.

[9] Let us just briefly mention that understanding of non-instrumentalism should not be confused with elements of instrumentalist methodology in Schumpeter, Shionoya, (1997).

[10] Hirshleifer (1994), p.5.

[11] Schumpeter (2006), p.329. It would be very interesting to compare the ideas of Jacob Viner on the relation between "the power of state" and economic categories with the idea of a positive reinterpretation of mercantilism with Schumpeter's ideas. Viner (1948), p.27.

[12] Schumpeter (2003), p.4.

It is important that Schumpeter does not want the above-mentioned claim about "objectless" imperialism to be understood in terms of apriorism (this explains the fact that Schumpeter uses the plural form to talk about imperialism). This also indicates a methodological shift in comparison to his earlier papers, to focusing on history and the recomposition of the theory-history relationship. This is also reflected in his attitude of deference to certain results of the German Historical School, and his general respect for historical facts as a "contingent necessity".[13] He does not underestimate military expansion in the course of history and illustrates the relevance of military ventures using selected historical examples. His readers gain insight into the causal relations between these forms of expansion and military forms of habitus: this is how "warrior classes" survive, whose existence is closely intertwined with interest regimes regarding wars.

A certain instrumental aspect is undoubtedly present in Schumpeter's argumentation concerning the conduct of imperialistic wars. In addition, this is exactly the moment where with regard to military classes Schumpeter offers a basis for those (libertarian) interpretations which locate war stimuli in the antagonistic conflict between "ruling" actors and ruled classes. Imperial Rome serves as a prime example.[14] Following this train of thought, the stimuli for war are seen as internal (thus the point is not waging war against foreigners, etc.), which brings Schumpeter closer to some other authors. Further, identifying the impulse to go to war in the relationship between rulers and ruled provides certain libertarian economists with the basis for assertions about the 'rule of the oligarchy' and the existence of 'unproductive classes' or, using fiscal language, 'tax-payers' and 'tax-consumers'.[15] However, Schumpeter differs here from Murray Rothbard, for example, who developed a praxeology of the war on the basis of the "logic of war-making" because, as will be shown, he has a different attitude toward the moments of "choice, reason and purpose".

It is of utmost importance that Schumpeter views the capitalism existing during WWI from a diachronic perspective. Schumpeter defines capitalism on the basis of a) private property, and b) the innovation generated within it on the basis of borrowed money, which implies credit creation. It is well known that he wrote and thought extensively about the long-term fate of capitalism,[16] which exists together and simultaneously with non-capitalist elements (occasionally also called 'atavistic' aspects). This is not 'pure', completed capitalism: imperialism needs to

[13] Here is a characteristic remark by Schumpeter which proves his commitment to historical considerations: "I do not think that Ricardo ever did much historical reading. But this is not what I mean. The trouble with him is kin to the trouble I have, in this respect, with my American students, who have plenty of historical material pushed down their throats. But it is to no purpose. They lack the historical sense that no amount of factual study can give. This is why it is so much easier to make theorists of them than economists." Cited by Boldizzoni (2011), p.9.

[14] Salerno (2008), pp. 447-457.

[15] Rothbard (1996). pp. 45-69.

[16] Lakomski (2002), pp.146-165.

be thematized within pre-capitalist structures. It follows, therefore, that WWI was the outcome of pre-capitalist structures. Unlike Marxist authors, to whom imperialism is inherent in capitalism, here it represents a transition phase in the gradual ending of capitalism; it demonstrates only residual characteristics of pre-capitalist structures within capitalism itself. Territorial expansion in the form of imperialism remains as “instinctual inclination”, which is “without any definite utilitarian limits”. Pure capitalism is the disappearance of diachronic structures. Therefore an imperialistic war cannot be interpreted from the perspective of “war-making” on the basis of the general logic of end-means. On the contrary, Schumpeter maintains that, from the perspective of pure capitalism, imperialism represents a condensation of irrationalism. It is no coincidence that Schumpeter, who regards capitalism as a “civilization”, treats the dynamics of capitalism as the advance of rationalism, *tout court*. In that way imperialism must also gradually (from the perspective of evolutionary logic) retreat: the competitive system that increases the dynamics of capitalism absorbs the excessive energy of its actors. Schumpeter particularly insists on the notion of social leadership, which represents the pillar of his theoretical considerations (it is worth reading his explanation of the relation between social leadership and entrepreneurship, which has often been interpreted as ‘elitist’): the bourgeoisie, focused on economic activity, generates positive externals in relation to society as a whole. Its focus on economic activity results in pacifism penetrating throughout society. In view of the fact that the bourgeoisie has leadership competence, an extrapolation can be made about the expanding combination of pacifism and economic energies.

Consequently, “a purely capitalist world .... can offer no fertile soil to imperialist impulses.”[17] Between a “purely capitalist world” and war there is no causal or logical connection. In a situation where “free market-based order” prevails, no class has an interest in systematically developing territorial expansion. Capitalism is destined to be peaceful if it is liberated from residual aspects of the past, or if production relations in capitalism can be viewed as synchronic. Capitalism as an embodiment of rationalism assumes overcoming “habitual emotional reaction”.

While some analysts view Schumpeter’s notions on the relationship of capitalism and socialism after WWI (particularly those regarding the decomposition of capitalism) as pessimistic,[18] there are others who see them as over-optimistic. How is it possible to speak of a world of pure capital in the historical circumstances of WWI, which, according to Max Weber (who was significant to Schumpeter), enabled legitimistic and unlimited disposition of manpower and economic goods, even in countries with strong liberal traditions?[19] Is this but a counterfactual indication? At least it should be noted that Schumpeter talked about objective tendencies and

[17] Schumpeter (1966). p. 69.
[18] Özveren (2000) p. 56.
[19] Weber (1968), p. 276. Losurdo (2011), p. 279. MacDonald (1965), p. 377.

about the "workability" of certain orders (capitalism and socialism) which depend upon the complex interaction between economic and non-economic factors. He frequently pointed out that there are no unique determinations that could serve as a basis for the linear connection between cause and effect. In addition, it cannot be said that Schumpeter underestimated the past; on the contrary, it appears that his focus on imperialism in the context of WWI was in fact the result of his conviction that "the dead always rule the living".

Schumpeter acknowledges the existence of a conjuncture of interests which fuel a war economy, but they represent only a minor dimension within the constellation of pure capitalism. He draws attention to certain phenomena which develop during the war: thus he makes a comparison between the economic situation during the war and luxury in relation to price movements ("increased demand at panic prices"), allows for the possibility of certain social actors generating enormous income, and perceives the possibility of power shifting during war, or the possibility of the economic subject changing time-preferences; but these can be interpreted only within the perspective of general tendencies. These shifts are only minor, and finally, the capitalist class have no motive for encouraging war. The irrationality of war means that it cannot be understood from the perspective of welfare maximization, or economic competition for resources; that is, on the basis of an economic repertory.

Here we approach the next important element in Schumpeter's analysis of imperialism. It is extremely significant that in his thematization of aggressiveness he begins by indicating the state. He frequently talks of the state ("conduct of the state"), which brings us to the territorial element in Schumpeter's argumentation in which there is a string of different indications related to structuring of territory as the ordering of space throughout history. Schumpeter believes that separate geopolitical competition exists between states. In fact, the residual element of territorial expansion that can be seen in WWI is the consequence of a combination of geopolitical competition, that is, inter-state relations, and pre-capitalist absolutism (mercantilism). These are not modes of competition related to capitalism but rather autonomous forms of competition joined to pre-capitalistic structures, and therefore they are not capitalistic and economic but political modes of competition. Schumpeter thus argues the co-existence of two forms of competition, one economic and the other political. This schismatic split can explain both WWI and imperial ambition for territorial expansion: intensification of political competition results in negative economic consequences.

2. SCHUMPETER'S THEORY OF IMPERIALISM FROM A WIDER PERSPECTIVE

It has already been mentioned that Schumpeter's theory can be seen as a continuation of pre-war discussions on imperialism. However, there are indications that, both retrospectively and prospectively, it can also be viewed within a wider context. For example, John Stuart Mill presented economic arguments for the affirmation of liberal imperialism[20]: he claimed that England faced a surplus of capital and population with a tendency for profits to fall. This constellation justifies colonial expansion; in other words, capitalism requires the existence of an empire.[21] It is interesting to contrast Mill and Schumpeter: Mill develops a political and economic theory of imperialism, while the Austrian economist's dominant reasoning is that imperialism can be understood only from a non-economic perspective. In fact, economic historians who refute the concept of 'economic imperialism' often quote Schumpeter.[22]

After Schumpeter, the economists Ludwig von Mises and Lionel Robbins[23] also wrote about the relation between war and the economy. They, too, found it necessary to deal with the theory of imperialism, although they used different arguments from Schumpeter. However, they agreed with Schumpeter that WWI could only be understood through an analysis of imperialism.

However, the most relevant comparison is between Schumpeter's theory of imperialism and contemporary Marxist theory, which was also very concerned with interpreting imperialism. It is difficult to resist the impression that there is strong interface between Marxists and Schumpeter in the context of WWI, and the analogies between Schumpeter and Karl Marx are often discussed. Despite having some criticisms, Schumpeter admired Marx, and both economists were concerned with the dialectics of stability and the instability of capitalism. Here we will focus only on specific instances of interface between Schumpeter and Marxism, concerning the interpretation of imperialism and WWI. This, however, is not to diminish the originality of Schumpeter's mode of approach, which is the foundation of his uniqueness.[24]

There have been various interpretations of the relationship between Schumpeter's ideas and Marxist views; those of Karl Kautsky and Rudolf Hilferding stand out. We are not talking about empirical interference here, but robust conceptual

---

[20] The term 'liberal imperialism' was coined in the 19th century, see attempts at moral justification, Mantena (2010), Weltmeyer (2013). For modern discussions see Fowler (2011). Some argue that the term should be changed, Margulis, McKeon, Borras Jr. (2013). Kettel, Sutton (2013).

[21] Mill, (1963), Critical review: Rothbard (1995), p. 288.

[22] Fieldhouse (1961), Koebner (1949).

[23] Mises (2007). Robbins (1968), pp. 40-62.

[24] Our claim is similar to the orientation of Appel (1992). However, only to certain degree: Appel claims that Schumpeter's true source is Sombart, who Schumpeter rarely mentions. .

analogies between Schumpeter and certain Marxist tendencies in relation to the understanding of WWI.

During WWI Kautsky was an influential figure within Marxism. Kautsky developed his thoughts on imperialism much earlier than Schumpeter, and they are analogous with Schumpeter's ideas[25] (let us not forget the fact that they were both in the Committee for Nationalisation, mentioned earlier). Kautsky utilised very similar argumentation: pure industrial capitalism is peaceful, therefore it cannot lead to world-scale war. WWI has its roots in pre-industrial and pre-capitalist structures. Even accentuating the state as the generator of imperialist impetus shows convergence between the two theoreticians. Similarly, their ideas are analogous as regards the intensification of state and military spending. Kautsky, too, places the source of territorial expansion, i.e., military understanding of territory, within the activities of warrior aristocracies. Colonialism is not the result of industrial capitalism, whose interests had previously been in coexisting peacefully with agricultural areas of the world. The free market is accompanied by pacified forms of behaviour. Paradigmatic 'British imperialism' can be regarded as a defence against other countries' territorial expansion. Schumpeter here goes further than Kautsky by explicitly denying British imperialism, emphasizing more robustly the defensiveness of British territorial activities - its "defensive imperialism". British performance is not an expression of structural trends but rather a deviation. However, a clear parallel between Kautsky and Schumpeter is the projection that imperialism will gradually disappear with the advance of capitalist dynamics.

It is true that Kautsky altered some aspects of his views.[26] With the outbreak of war in 1914 he changes his perspective and places imperialism within advanced capitalism. However, it should be noted that Kautsky, who was strongly influenced by Hilferding and wrote a review of Hilferding's renowned book about financial capital, now views territorial expansion as the expression of the ambitions of financial capital. Hence, the diachronic dimension inherent in the process of capitalism is reiterated: financial capitalism appears as a pre-capitalistic element that spurs territorial ambition due to the dynamics of industrial capitalism. Therefore the scheme is altered, but the underlying fibre, namely the problematic coexistence of pre-capitalistic and capitalistic elements, has remained. In Kautsky's opinion, WWI can be perceived in terms of a bond between warrior aristocracies and financial capital. Schumpeter, on the other hand, emphasized protectionism associated with the mercantilist period. However, regardless of the differences, both were inclined to recognize the relation between capitalism and imperialism as contingent.[27]

[25] Kautsky (1927), p. 67-81. On this, Kautsky, (1961). The question remains whether Kautsky is a "Schumpeterian Marxist". Kurz (2013). Rosenberg (2011).

[26] Kautsky (1914). See, Howard, (1989), pp. 91-94.

[27] On the explanation of this, see: Kautsky (1961), p.122. Blackledge, (2006).

We should notice the considerable influence of Hilferding on both Schumpeter[28] and Kautsky. For Hilferding, imperialism certainly represents the most recent phase of capitalism, which culminates in WWI; consequently imperialism is an expression of capitalism's actual dynamics and not a residual constellation, as Schumpeter understands it. Although Schumpeter did not use the term 'financial capitalism' he did speak of 'monopoly capitalism', trusts, and cartels, creating meanings which can be understood only on the basis of Hilferding's perspective. Hilferding emphasizes banks in relation to the creation of trusts and cartels, as well as the "close alliance between high finances and the cartel magnates".[29] Schumpeter speaks of asymmetry: high finance controls a large proportion of capital although it represents only the minority interest.[30] Finally, Schumpeter's reflexions resemble Hilferding's when it comes to the dynamic presentation of capitalism. There are different "stages", actually different phases of capitalism which successively complement each other, so that there is competitive capitalism with small companies competing against each other, and there is "monopoly capitalism" which peaks with WWI. Schumpeter spares no praise regarding the neo-Marxist account of the phenomenology of "monopoly capitalism", saying that only neo-Marxists recognized new elements and causal relations concerning different modes of protectionism and the existence of trust and cartels, and here he *expressis verbis* mentions Hilferding.[31]

Despite the fact that Schumpeter was non-Marxist, it is no exaggeration to propose the existence of a Hilferding-Kautsky-Schumpeter triad regarding imperialism. Together they express paradigmatic views concerning the economic flows of WWI. The conceptual analogies are clear. In the Marxist theory of that period there are ideas which perceive capitalism diachronically and project the existence of autonomous geopolitical competition, and thus interpret imperialism either as a remainder of pre-capitalism or as the expression of a new historical phase. (Marx conducts his analysis of capitalism from a synchronic rather than diachronic perspective: for that reason imperialism is for him an immanent category of capitalism and not just an expression of one phase in the dynamics of capitalism.[32]) Furthermore, it is worth mentioning that Schumpeter's explanation of separated geopolitical competition as a driving force of imperialism and of phases in the periodization of capitalism leaves its mark on post-Marxist analysis as well.[33]

28 Michaelides Milios, (2005) Michaelides, Milios (2014). William (2012). Chaloupek (2013).
29 Schumpeter, (1966), p. 81.
30 On the differences between Schumpeter's and Hilferding's understanding of banks in the context of WWI, see Reisman (2004), p. 51. On the extreme significance of the financial sphere for understanding Schumpeter, see Kingston, (2014).
31 Schumpeter (1966), p. 79.
32 About the fact that with Marx imperialism necessarily exists in terms of open dynamics of capital, see Pradella, (2013).
33 Harvey, (2003).

3. PROBLEMATIZING THE THEORY OF IMPERIALISM IN THE LIGHT OF WWI

Schumpeter's theory of imperialism represents the highest achievement in the liberal understanding of capitalism. His framing of the short- and long-term implications of WWI was very sophisticated. His central claim is that imperialism is not endogenous to capitalism, but is a political phenomenon. Positional goods as a power belonging to a military aristocracy will be replaced by gradual rationalization. WWI should be perceived as a transitional phase towards pure capitalism, that is, as a period of collective learning.

Schumpeter operates with the category he calls "pure capitalism" (he frequently uses expressions with "pure"; so he also says that there is no "purely economic reason" why capitalism should not enjoy new success and stabilization[34]). Next, any association with Schumpeter involves his (direct or indirect) explanation of the relations between politics and the economy, or, more generally, between economic and non-economic motives. This intriguing relationship allows for different interpretations and thus leads to talk of paradoxes when discussing Schumpeter.[35] He is often interpreted as a conservative liberal: in his perception of capitalism he combined conservatism (e.g., the necessity of a social hierarchy) and liberalism. An economist who was highly methodologically aware, he entrusted us to think carefully about the modus in which we confront him, which cannot be simplified. We know that Schumpeter's analysis differs from orthodox orientation: he specifically emphasized the domain of the pre-analytical sphere ("vision") as a moment that preceded the analytical work that orients the framework of economists. Certainly, we cannot understand Schumpeter's reflections without taking into account the existence of a pre-analytical moment in his approach to WWI. It could be said that his attempt to synthesize theory and history was marked by his pre-analytical work. Is it possible to understand his ideas without considering his conservative liberalism which projects peaceful capitalism? Can we penetrate his reflections without knowing that he ascribes a "supernormal quality"[36] to the bourgeoisie, the agent of social leadership?

Schumpeter's analysis is well founded, and at times intriguing. Thus, it is no coincidence that he refers to pre-capitalistic elements in his analysis of WWI imperialism: indeed, research shows a significant presence of pre-capitalistic players in economic life, with some analysts going so far as to present WWI within the framework of confrontation with pre-capitalistic strata and as emphasizing special tensions of industrial capitalism with pre-capitalistic moments as the main driv-

[34] Schumpeter (2003), p. 203.
[35] Tsuru, (2003) p. 264. Heilbroner (1984).
[36] On this, Heilbroner (1993).

ing force.[37] In addition, his analysis that thematizes imperialism and WWI as an expression of internal conflicts between rulers and the ruled has been confirmed by later research.[38] Finally, not only did Schumpeter present convincing arguments against economicism (particularly present in Marxism) but he warned of the fatal and reductive derivation of interest regimes from the existence of imperialism. When he claims that there is divergence between the "reason" and the "cause" of WWI and when he says the interest which explains the outbreak of war is not located in "concrete war aims", he is warning of the necessity of a complex procedure. Only such a procedure enables a careful analysis of the reason and causes of war, and of the deliberate decision to accept the risks of war.[39]

However, our 'vision' is that imperialism from the perspective of WWI is a political and economic phenomenon. This is not just empirical opposition to Schumpeter's interpretation of WWI; it means that we do not separate (geo)political and economic competition as Schumpeter does. Our methodological choice is conditioned by the fact that a political and economic framework offers enhanced explanatory opportunities for understanding war, and thus also WWI. It enables what John Hicks (*Causality in Economics*) describes as "simultaneous causality".

We can rely on economic history but also on economic and theoretical reflection. Military orientation existed in a variety of relations with economic determinants, but it would be reductive to equate wars with destructive consequences. On the contrary, military ventures must be analysed in connection with economic elements, with mutual determinants existing between them: war regimes alter the economy, but there is also a reverse influence. It can be claimed that wars often shape economic conditions. In addition, the constituent categorical pair, power and plenty, whose relation to mercantilism Viner analysed so subtly, can provide direction both in a broader sense and in relation to WWI. Paul Post spoke of the "Iron Law of War", which implies a tendency for war to fuel the economy.[40] This assumes analysing economic motivation, that is, economic calculations of war that clearly indicate that there are economic reasons and causes in relation to war. However, the fact that war generates self-perpetuating economic processes must not be interpreted as a necessity: every military act signifies risk, which must be carefully estimated.

Schumpeter's remark that pre-capitalistic societies are determined by "objectless expansion" "without definitive utilitarian limits", which also determines his ideas about WWI, is nevertheless reductive. As some research[41] has shown, pre-capitalistic territorial expansion cannot be explained as 'atavistic' from the perspective of irrational impetus without being reductive: there is a different type of

[37] Mayer, (1981).
[38] Mayer (1969).
[39] Perelman (2004), pp. 297-306.
[40] Poast (2006). Ettinger (2013).
[41] Regarding China with critical review of Schumpeter, see Arrighi (2010), p. 37.

rationality practiced in capitalism, which also has "prospective benefits" based on the victory of territorial control. These conquests are undertaken to realize strategic commands; thus they are not "objectless". This is how we should perceive the European maritime supremacy which was established during pre-capitalistic periods: for Europeans it secured strategic advantage in the world system, with significant direct and indirect economic consequences. Thus the naval power of Europe secured suitable labour force dynamics as well as a certain regime of demands. Only a political-economic approach can explain the full meaning of Pareto's claim that war has become in its essence an economic phenomenon.[42] This can be explained only after taking into consideration political and economic arguments, which transcends purely economic calculation but at the same time indicates the complex interaction between the political and economic spheres. Precisely this moment demonstrates that in the light of WWI, imperialism cannot be understood in terms of 'atavism' and remaining pre-capitalistic elements.

Military history shows an interface between the dynamics of the market and military orientation. We can indicate how "commercialization of organised violence", i.e., involvement of market logic in military regimes, represents a constituent aspect of economics.[43] Crucial movements in military history indicate the modalities in which military dynamics sometimes existed in parallel with the dynamics of capitalism and sometimes generated certain flows within capitalism. The economic theory that primarily considers 'creative power' cannot be indifferent towards the 'destructive power' which is located in different military regimes. Therefore it is necessary to see that the immanent mechanism of capitalism extended and intensified the phenomena of "destructive power", which can also be demonstrated by the instrumentarium of economic theory.[44]

Schumpeter's belief that there is a cause and effect connection between the advancement of capitalistic non-heroic rationality and gradual pacification is questionable. Theoreticians relevant to the perception of capitalistic rationality, such as John Locke, legitimized war and colonial territorial expansion based explicitly on categories such as "waste" or scarcity.[45] These are genuine economic categories, not just atavistic remains. That is why we can speak of "war on waste" as a strictly economically legitimate activity. In addition, econometric results leave room for doubt and show indeterminacy. Thus the expansion of market networks fosters intensified cooperative relations and the enjoyment of mutual benefits (that is, virtues of cooperation) but also the creation of dependencies which create sparks

---

[42] Pareto (1963) 1516. Quoted by Vahabi (2004), p. 158.
[43] McNeill (1982).
[44] For the precise definition of destructive power in the economic sense, see Vahabi (2004), p. 69.
[45] Neocleous, (2014), pp. 48-53. O'Rourke, and Finlay, (2007), p. 366.

of conflict: corresponding economic theories have indicated different conflict potentials in dyadic and triadic relations.[46]

Let us also mention the context which Schumpeter particularly thematised. His argumentation regarding 19th century imperialistic ambition rarely mentions the mutual relations between finances, military activities, and territorial aspirations, and without that it is impossible to fathom the modus of British imperialism. For example, an important moment was when Great Britain had contrasting economic policies, account deficits with rival countries and an account surplus with its colonies.[47] The current balance problem was solved and decided in Victorian imperialism through a combination of military intensification and territorial expansion. In other words, the treatment of colonies involved simultaneous military and capitalistic measures. Finally, the current balance problem was managed in a way that secured the City of London's strategic command of world finances. The claim seems plausible that without Asian countries and the triadic relations (with asymmetric dimensions) with China and India, Great Britain would not have been able to maintain the regime of free trade whose agent and protagonist it was.[48] When John Stuart Mill advocated military intervention regarding the Second Opium War he was using 'non-heroic' rational legitimation to remove obstacles to the expansion of the free market. In other words, the Second Opium War was fought in the name of the supremacy of the free market.[49] (French politician Jules Ferry stated that "colonial policy is the daughter of industrial policy", and earlier the great thinker Benjamin Constant said, "War and commerce are only two different means of achieving the same end, that of getting what one wants... War is all impulse, commerce, calculation".) As a general conclusion we should bear in mind Albert Hirschman's path-breaking article[50] in which he classifies the effects of the market and projects as one modus of effect the market's destructive influence. Economists can establish relations between the "destructive power" and the "destructive effects" of the market.

Finally, WWI is inconceivable without an intensified bond between industry and the military sector. This is instrumental for understanding mass war (particularly the intensified "military participation rate") as well as the enormous destruction (Schumpeter himself attaches importance to the fact that WWI caused greater destruction than any earlier military campaign). The economic context is "competition based on the increasing returns to scale" (Perelman): the frequently mentioned concentration of capital or "extensive markets", mentioned by Adam

[46] The originator is Hirschman [1945] (1980). Barbieri (2002), p. 36. See O'Rourke, and Finlay, (2007), p. 366. Hess (2009), Kiely (2014).

[47] Patnaik (2009), p. 236. Davis (2000).

[48] Latham (1978).

[49] Sullivan (1983). Although it should be stated that there is also liberal opposition to imperialism (Theodor Mommsen, for example).

[50] Hirschman, (1982).

Smith, should be interpreted in this way also. In addition, the *ex ante* and *ex post* costs of the war should be considered in this framework.

WWI had irreversible political and economic consequences. The paths of the industrialization of the war, the stabilized autonomy of the military sector or stabilization of the 'military-industrial complex' as it was later termed, the huge investment in military research: all this has to be refracted through WWI. But, *pace* Schumpeter, this can be interpreted only if 'imperialism' is not reduced to atavistic habitual impulses but is understood as part of a complex whole. It is precisely the wider context of WWI that demonstrates the entwinement of military, economic, and politic aims.

4. CONCLUSION

Schumpeter's theoretical articulation of WWI was realized on the basis of his understanding of imperialism, that is, on a wider interpretation of the long-term tendencies within capitalism. He analysed a theoretical framework for understanding WWI and the related consequences. The characteristic features of his work can be described as: a) imperialism represents a residual element within capitalism, b) imperialism is a political phenomenon, c) capitalism needs to be studied diachronically, d) there is separated geopolitical interstate competition and e) capitalism is peaceful, as it contains unheroic rationality. In his analysis Schumpeter made relevant suggestions regarding a) the existence of pre-capitalistic strata in WWI and b) the limitation of economicism. We criticized Schumpeter by presenting the following argumentation: a) imperialism is a political and economic phenomenon, b) capitalism also needs to be observed synchronously, and c) imperialism is not only a complex of atavistic phenomena but is also determined by elements of economic rationality. WWI stabilized the military and industrial complex and the related irreversible results.

REFERENCES

Appel M. (1992), *Werner Sombart: Theoretiker und Historiker des modernen Kapitalismus*. Metropolis, Marburg.

Arrighi, G. (2010), *The Long Twentieth Century*, Verso, London, New York.

Barbieri, K. (2002), *Liberal Illusions, Does Trade Promote Peace*, The University of Michigan Press, Ann Arbor.

Blackledge, P. (2006), Karl Kautsky and Marxist Historiography, *Science & Society* Vol. 70, No. 3, July, pp. 337-359.

Boldizzoni, F. (2011), *The Poverty of Clio, Ressurecting History of Economy*, Princeton University Press, Princeton.

Chaloupek, G. (2013), Finanzkapital und Finanzsysteme "Das Finanzkapital" von Rudolf Hilferding, *European Journal of the History of Economic Thought*. Vol. 20 Issue 1, pp. 158-162.

Davis, M. (2000), The Origin of the Thirld Word *Antipode* 32, 1, pp. 48-89.

Ettinger A. (2013), Neoliberalism, the State and War, *Millennium - Journal of International Studies*, 41, 2, pp. 379-393.

Fieldhouse, D. (1961), Imperialism': An Historiographical Revision *The Economic History Review*, New Series, Vol. 14, No. 2, pp. 187-209.

Fowler, B. (2011), The Mythology of Imperialism, *Critique* 39, 3, pp. 457-461.

Harvey, D. (2003), *The New Imperialism*, Oxford University Press, Oxford.

Heilbroner, R. (1984) Economics and Political Economy: Marx, Keynes, and Schumpeter *Journal of Economic Issues*, Vol. 18, No. 3 pp. 681-695.

Heilbroner, R. (1993) Was Schumpeter Right After All? *The Journal of Economic Perspectives* Vol. 7, No. 3 pp. 87-96.

Hess, G.D. (2009), *Guns and butter: The economic causes and consequences of conflict*, MIT Press, Cambridge and London.

Hirschman, A. (1982), Rival Interpretations of Market Society: Civilizing, Destructive, or Feeble? *Journal of Economic Literature* 20, pp. 1463-1514.

Hirschman, A. O. (1980), *National Power and the Structure of Foreign Trade*. Publications of the Bureau of Business and Economic Research, University of California, Berkeley and Los Angeles.

Hirshleifer, J. (1994) The Dark Side of the Force *Economic Inquiry* XXXII, January, pp. 1-10.

Howard, M. C. and King, J. E. (1989) *A History of Marxian Economics*, Princeton University Press.

Kautsky, J. (1961) J. A. Schumpeter and Karl Kautsky: Parallel Theories of Imperialism, *Midwest Journal of Political Science* Vol. 5, No. 2, pp. 101-128.

Kautsky, K. (1914) Der Imperialismus, *Die Neue Zeit* XXXII/2, pp. 918- 919.

Kautsky, K. (1927) *Die materialistische Geschichtsauffassung*, J. H. W. Dietz Nachf., Berlin

Kettel, S, Sutton, A. (2013), New Imperialism: Toward a Holistic Approach, *International Studies Review* Vol. 15, pp. 243-258.

Kiely, R. (2014) Imperialism or globalisation?...Or imperialism and globalisation: Theorising the international after Rosenberg's 'post-mortem', *Journal of International Relations& Development* Vol. 17, Issue 2, pp. 274-300.

Kingston, W. (2014), Schumpeter and the end of Western Capitalism, *Journal of Evolutionary Economics* 24, pp. 449-477.

Koebner, R. (1949), The Concept of Economic Imperialism, *The Economic History Review* New Series, Vol. 2, No. 1, pp. 1-29.

Krause, G. (2003) On a Virtually Forgotten Essay: Joseph A. Schumpeter's "The Sociology of Imperialisms", in Backhaus (ed.) (2003) *Joseph Alois Schumpeter, Entrepreneurship, Style and Vision*, Kluwer Academic Publishers, New York, Boston, Dordrecht, London, Moscow, pp. 179-191.

Kurz, H. (2013) Schumpeter and Marx: a comment on a debate, *Industrial & Corporate Change* Vol. 22, Issue 2, pp. 577-584.

Lakomski, O. (2002) The long term perspective Schumpeter's prediction of the end of capitalism, in Arena et al. (ed.) (2002) *The Contribution of Joseph Schumpeter to Economics Economic development and institutional change,* Routledge, London, pp. 146-165.

Latham, A. J. H. (1978) *The International Economy and the Underdeveloped World*, 1865-1914, Croom Helm, London.

Losurdo, D. (2011), *Liberalism*, Verso, London.

MacDonald, R. (1965), Schumpeter and Max Weber-Central Visions and Social Theories, *The Quarterly Journal of Economics* Vol. 79, No. 3, pp. 373-396.

Mantena, K. (2010), *Alibis of Empire: Henry Maine and the Ends of Liberal Imperialism,* Princeton University Press, Princeton.

Margulis, M. E., McKeon, N. M., Borras S. Jr. (2013), Land Grabbing and Global Governance: Critical Perspectives, *Globalizations* Vol. 10, No. 1, pp. 1-23.

Mayer, A. J. (1969), Internal Causes and Purposes of War in Europe, 1870-1956: A Research Assignment *Journal of Modern History* Vol. 41, No. 3, pp. 291-303.

Mayer, A. J. (1981), *The Persistence of the Old Regime*, London.

McNeill, W. H. (1982), *The Pursuit of Power, Technology, Armed Force, and Society A.D. 1000*, University of Chicago Press, Chicago.

Michaelides P., Milios J. (2005), Did Hilferding influence Schumpeter? *Historical Economy Review* 41, pp. 98-125.

Michaelides, P. G., Milios, J. (2014), The Schumpeter–Hilferding Nexus, *Journal of Evolutionary Economics* DOI 10.1007/s00191-014-0361-9.

Mill, J. S. (1963) A Few Words on Non-Intervention, in Himmelfarb, (ed.), (1963) *John Stuart Mill: Essays on Politics and Culture*, Anchor Books, Garden City, pp. 368-384.

Mises, L. von (2007), *Human Action: A Treatise on Economics*, Liberty Fond, Indianapolis.

Neocleous, M. (2014), *War Power, Police Power*, University Press, Edinburgh.

O'Rourke, K. & Finlay, R. (2007), *Power and plenty: trade, war, and the world economy in the second millennium*, Princeton University Press, Princeton.

Özveren, E. (2000), Capitalism and democracy at a crossroads: the civilizational dimension, *Journal of Evolutionary Economics* 10, pp. 49-65.

Pareto, V. (1963), *The Mind and Society, A Treatise on General Sociology*, 4 vols, Dover Publications, New York.

Patnaik, P. (2009), *The Value of Money*, Columbia University Press, New York.

Perelman, M. (2004), Speculations on the Political Economy of War and Empire, *Review of Radical Political Economics* Vol. 36, No. 3, pp. 297-306.

Pigou, A. (1921), *The Political Economy of War*, Macmillan, London.

Poast, P. (2006), *The economics of war*, McGraw Hill, New York.

Pradella, L. (2013), Imperialism and Capitalist Development in Marx's Capital, *Historical Materialism* 21, 2, pp. 117-147.

Reisman, D. (2004), *Schumpeter's Market, Enterprise and Evolution*, Elgar, Cheltenham.

Robbins, R. (1968), *Economic Causes of War*, Howard Fertig, New York.

Rosenberg, N. (2011), Was Schumpeter a Marxist? *Industrial & Corporate Change* Vol. 20, Issue 4, pp. 1215-1222.

Rothbard, M. N. (1996), *For a New Liberty: The Libertarian Manifesto*. 2d ed., Wilkes and Fox, San Francisco.

Rothbard, M. N. (1995), *An Austrian Perspective on the History of Economic Thought, II: Classical Economics*, Edward Elgar, Cheltenham, UK.

Salerno, J. T. (2008), Imperialism and the Logic of War Making, *The Independent Review* XII, n. 3, Winter, pp. 447-457.

Schumpeter, J. A. (1908), *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie*. Duncker, & Humblot, Leipzig.

Schumpeter, J. A. (1912), *Theorie der wirtschaftlichen Entwicklung*, Duncker & Humblot, Leipzig.

Schumpeter, J. A. (1966), *Imperialism and Social Classes*, A Meridian Book, New York.

Schumpeter, J. A. (2003), *Capitalism, Socialism, Democracy*, Routledge, London, New York.

Schumpeter, J. A. (2006), *History of Economic Analysis*, Taylor & Francis e-Library.

Shionoya, Y. (1997), *Schumpeter and the Idea of Social Science*, Cambridge University Press, Cambridge.

Skidelsky, R. (1983), *John Maynard Keynes, Hopes Betrayed 1883-1920*, Macmillan, London.

Smaldone W. (2012), Can Capitalism Lead to Peace? Revisiting Hilferding's Theory of "Realistic Pacifism." *Radical Philosophy Review* Vol. 15 Issue 1, pp. 203-218.

Stolper, W. F. (1982), Aspects of Schumpeter's Theory of Evolution, in Frisch, (ed.) (1982), *Schumpeterian Economics*, Praeger, New York, pp. 28-48.

Sullivan, E. P. (1983), Liberalism and Imperialism: J. S. Mill's Defense of the British Empire. *Journal of the History of Ideas* 44, 4, pp. 599-617.

Tsuru, S. (1993), Two studies of Schumpeter's life: a review essay, *Journal of Evolutionary Economics* 3, pp. 263-268.

Vahabi, M. (2004) *The Political Economy of the Destructive Power*, Elgar, Cheltenham.

Veltmeyer, H. (2013), The political economy of natural resource extraction: a new model or extractive imperialism? *Canadian Journal of Development Studies/Revue canadienne d'études du développement* Vol. 34, 1, pp. 79-95.

Viner, J. (1920), Who Paid for the War? *Journal of Political Economy* Vol. 28, No. 1, pp. 46-76.

Viner, J. (1948) Power and Plenty, Power Versus Plenty as Objectives of Foreign Policy in the Seventeenth and Eighteenth Centuries, *World Politics* Vol. 1, No. 1, pp. 1-29.

Weber, M. (1968), *Der Sinn der "Wertfreiheit" der soziologischen und oekonomischen Wissenschaften*, Fisher, Frankfurt am Main.

Young, A. A. (1926), Economics and War: A Presidential Address, *The American Economic Review* Vol. 16, No. 1, pp. 1-13.

Chapter 5

International Business and Investments at the Time of the First World War

Sandra Stojadinović Jovanović*
E-mail: sandra@ekof.bg.ac.rs

Milena Jakšić**
E-mail: milenaj@kg.ac.rs

Abstract: The development and expansion of international business is interconnected with increasing investment across national borders. The paper deals with historical trends in the development and movement of international business operations and direct investment abroad. It analyses changes in international business and investment flows before, during and after the First World War, taking into account the circumstances, conditions, and factors that influenced these changes. The paper also examines changes in the distribution of investment flows and in the orientation of firms and their cross-border business operations in different sectors at the time of the First World War.

Key Words: international business, international investments, First World War.

JEL Classification: F21, F23.

1. INTRODUCTION

International orientation is a phase in the development of traditional enterprises. Enterprises are first established in the form of a small sole proprietorship (one owner) operating within national borders (and sometimes solely in the local market). As an enterprise expands, its need for capital grows (the first stage of development) and it needs access to a larger market (the second stage of development).[1] The main forms of international business are: 1) traditional foreign direct investment (FDI), either in the form of full ownership or majority ownership of a subsidiary

* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179062) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

** The Faculty of Economics, University of Kragujevac. This paper is a part of the project (№ III41010) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia

[1] Rakita (1993), p. 104.

abroad, and 2) conventional exports to foreign markets. There is an array of intermediate forms of international business such as joint ventures, licensing, franchising, management contracts, turn-key contracts, and strategic business alliances, each of them implying a different combination of resources and capabilities, level of risk and control.[2] Direct investment is the main form of cross-border expansion, and becomes the focus when it is the most efficient means of achieving oligopolistic advantages. Nowadays, direct investment is boosted and supplemented by other forms of internationalization: trade, licensing and other forms of contractual cooperation. This rich variety of forms and their interconnection is a contemporary feature of firms' business orientation.[3]

Direct investments abroad were the first and the most significant means of expansion of international business operations: analysis of the historical development of international business and its origins shows that it was realized prevalently through direct investment abroad. The paper therefore analyses the developments and trends in business operations and direct investments abroad, based on the macroeconomic environment and the overall circumstances in which they took place. It deals with the changes in international business and investment flows before, during, and after the First World War, considering the relevant circumstances, conditions, and factors influencing these changes. The paper also examines changes in distribution of investment flows as well as changes in the orientation of enterprises and their business operations across borders in different sectors at the time of the First World War.

2. INITIAL DEVELOPMENTS IN INTERNATIONAL BUSINESS AND INVESTMENTS BEFORE THE FIRST WORLD WAR

During the 19th and at the beginning of the 20th century the extent and importance of international business in the world economy grew considerably. International trade and the rate of investment flows increased rapidly and almost all parts of the world were involved in international business. International trade companies expanded, international banking grew, and transportation and communications businesses developed significantly. The global economy grew hand in hand with the rise in capital flows, investment, labour force migration, and the production and trading activities of firms.

Initial developments in international business and investments were characterized by an increasing level of direct investment in a growing number of activities and countries at the beginning of the 19th century, followed by the emergence and dynamic development of international business in the mid-19th century. By the

[2] Stojadinović Jovanović (2008), p. 90.
[3] Stojadinović Jovanović (2008), pp. 82-83.

mid-19th century, considerable direct investment was being put into the extraction of minerals by different European countries. From that time on, FDI in production started to rise, as did investment in the banking sector, primarily because British banks began to set up subsidiaries in British colonies. Among the first FDI was German electronics company Siemens' investment in Russia. Singer's sewing machine factory in Glasgow, Scotland, opened in 1867, and is considered to be the first sustainable investment made by an American production company. There are no reliable estimates of the total amount of foreign investment in the mid-19th century. Total international capital flows by the 1870s, including both portfolio investments and FDI, were modest.

Macroeconomic conditions, especially the importance of the British economy in the first half of the 19th century, had a fundamental impact on international business in this early stage of its development. Many of the first investments made in this period originated from Great Britain. The British economy's demand for agricultural products and raw materials encouraged considerable investment in banking services and development of the banking sector which financed the trade flows. Japanese FDI, on the other hand, was insignificant both in this period and later. By the mid-19th century Japan was a closed economy without international trade relations.

Great Britain was the first country to formally adopt gold standard in 1819, to which most of Europe, the USA and a large part of the rest of the world switched in 1870s. During the gold standard era there was no foreign-exchange risk because exchange rates were simply determined on the basis of the mint parity. Furthermore, under the gold standard external balance took priority over internal balance. Limited amount of gold did not allow for a limitless increase in money supply, so the inflation risk was minimized. Due to the absence of the foregoing risks, majority of investments made in the period had the form of portfolio investments.

Foreign investments were well received worldwide in this period, enabling expansion of international business and direct investment abroad. This was partly due to the limited role of the state in the world economy. Restrictions on foreign ownership of property were few, there were few obstacles to foreign investment, and companies were free to look for the most profitable opportunities around the world. Additionally, the development of international property rights considerably reduced some of the risks involved in international business, especially confiscation of property, as foreign citizens' property could not be confiscated without compensation. There was no large-scale confiscation of foreign property before 1914. An attractive legal framework for development of international business was thus created.

National economic policies, which had to be shaped in line with gold standard rules, were trusted and had credibility. A secure environment stimulated flows of capital across national borders without major risk. Governments encouraged investment in countries over which they had strong political influence. There was a small possibility of unpredictable events. Loose market regulation and absence of limiting economic measures and interest groups allowed easy allocation and international movement of capital in the 19th century economies. Liberal social systems facilitated the free flow of goods, labour and capital at an impressive rate at the end of the 19th and the beginning of the 20th centuries. In this period the GDP growth rate in developing countries was much higher than in developed economies. Additionally, interest rates, prices, and real wages between countries converged.[4]

The business environment and macroeconomic circumstances before the First World War allowed for a rapid increase in enterprises' investments and business activities. Macroeconomic stability, global peace and economic openness stimulated international investment flows. The limited role of the state and the absence of restrictive bureaucratic procedures were especially important factors. The key drivers of investment were the search for lacking or cheaper resources and new markets, improved efficiency and reduced costs through economies of scale, and the search for a new technology base.

Since there was no legal control on capital flows, and portfolio investments, as the most significant form of capital flows at the time, carried a high level of risk, trade protectionism contributed significantly to a rapid rise in FDI in production. In America the Civil War lead to a considerable increase in the level of tariffs. Europe also returned to protectionism. However, an increase in sustainable FDI in production in the second half of the 19th century coincided with the adoption of free trade policies and economic liberalism in many developed economies. Large oil extraction and distribution companies emerged all over the world. Additionally, foreign direct investments were made in agriculture and raw materials, including tea, sugar and rubber plantations in developing countries and livestock production in the USA and Latin America. By the beginning of the First World War in 1914 many goods were produced internationally, including chemicals, pharmaceuticals, electrical products, machines, motor vehicles, tires, and cigarettes.

At the end of the 19th century, growth in new capital-intensive industries such as chemicals, electronics, and mechanical engineering was also very important, because these industries were large consumers of raw materials (copper, aluminium, zinc, tin). International trade grew at a much higher rate than world production, sometimes by more than 60% per decade, because the industrialized countries in Western Europe and North America traded industrial products for raw materials and foodstuffs produced in the developing parts of the world.

Unprecedented international human migration significantly affected international business. International migration in the first half of the 19th century was slow. However, in the second half of the century the industrial revolution, surplus

[4] Hirst and Grahame (2003), p.18.

manpower, a rise in unemployment, a shortage of arable land and agrarian overpopulation, enhanced railway and sea transportation, and the free flow of the unemployed accelerated international migration considerably, and it reached its peak in the decade preceding the First World War. Between 1820 and the First World War 44 million people emigrated from Europe, most of them (32 million) leaving their home countries after 1880. At the same time, 2 million people left Asia.[5] Mass international migration at the end of the 19th century had an impact on international business as it shaped consumer patterns. Domestic businesses tended to follow the pattern of international migration from their home countries. For the first time in human history, flows of trade, people, and capital created a world economy.

Innovations in transportation and communication technology also contributed to the increase of direct investment abroad and the expansion of international business, as they enabled exploitation of natural resources in distant areas and made it easier for companies to do business outside national borders without government privileges.[6] These innovations also facilitated management's control of remote business operations, which reduced the risks involved in FDI. An absence of major wars, the development of international property rights, and the rise of imperialism reduced the risks involved in international business and contributed to expansion of foreign investment and international business operations.

This period certainly saw a dynamic expansion of international business, but it is still hard to quantify its extent. Foreign investment between the 1870s and 1914 is believed to have been massive, but the exact extent and structure of international capital flows before 1914 are unclear. It is hard to make estimates of FDI on the basis of total foreign investment data because they include two components, direct and portfolio investments. The overall world stock of foreign investment in 1914 is usually estimated at USD 40 to 45 billion.[7] It was long believed that portfolio investments comprised almost 90% of capital flows in this period[8], but this estimate was revised in the 1970s. Dunning's estimate[9] of the world stock of FDI shows that about 1/3 of overall global foreign investment, or some USD 14,582 million, was in the form of foreign direct investment by 1914. This upward revision of the extent of FDI would mean that FDI accounted for about 9% of global GDP in 1913.

Great Britain, France, and Germany were the leading countries of origin for FDI in this period (Table 1). These three countries increased their investments from USD 10 billion in 1880 to USD 34.2 billion at the beginning of 1914, accounting for about 3/4 of global capital outflow before the First World War.

[5] Kenwood and Lougheed (1971), p.57.

[6] Before the 20th century special privileges or monopoly granted by government were the best means of ensuring the success of FDI.

[7] Jones (1996), p.29.

[8] The business environment contributed to it, as we have explained earlier in this part of the paper.

[9] Dunning (1993), p.117.

Table 1. Foreign investments of the three leading investors, 1880-1914 (billion USD)

Country	1874	1880	1890	1900	1914
Great Britain	4.6	5.8	9.5	11.7	19.6
France	-	3.0	4.0	5.6	9.0
Germany	-	1.2	2.8	3.4	5.6
Total	6.0	10.0	16.3	20.7	34.2

Source: Sodersten (1985), p. 101.

During the four decades preceding the First World War foreign investment grew at a faster pace than foreign trade and national income in these countries. This rapid increase in foreign investment can be attributed to high profits and reinvestment of profits abroad. British investments accounted for 40% of overall international investment before the First World War, totalling about USD 45 billion, while British, French, and German investments altogether accounted for 70%. With direct investment abroad totalling almost USD 20 billion in 1914, Great Britain was the leading world investor before the First World War. Britain's large share in global investments contributed to its continuing importance in the world economy. As the world's leading investor, Britain was home to numerous financial services and institutions and London became the world's first financial hub. France increased its foreign investments at the beginning of the second half of the 19th century, and Germany emerged as a significant investor in the 1880s.

The USA joined the leading world investors much later and only became a player in the field of international investment shortly before the First World War. Most investment from the USA, 80% in 1899 and 66% in 1914, was in the form of direct investments in Canada and Mexico and a smaller share in Europe.[10]

As companies tried to reduce the costs of management control of cross-border operations, one of the most efficient strategies was to invest in neighbouring countries or in countries that had a similar national culture. Mexico and Canada were the largest recipients of US FDI before 1914. Swiss, Swedish, Dutch, German, and other companies from continental Europe that made direct investments abroad also preferred geographical proximity, although they invested in the USA and other remote areas as well. German companies expanded their business operations to neighbouring countries: Austria, Switzerland and France. Like the investments of the British, Dutch, and other colonial powers in their colonies, investing in neighbouring countries involved fewer difficulties than investing in radically different host countries.

Canada, Australia, Argentina, and the Scandinavian countries were the largest recipients of foreign investment before the First World War, taking into account the share of foreign investment in domestic investment. At the end of the 19th

[10] Kenwood and Lougheed (1971), p.47.

and in the first decade of the 20th century even the USA financed some domestic investment (about 10%) with foreign capital. However, the rising importance of US and European FDI in the late 19th century bore witness to the expansion of industrialization and economic development. At the beginning of the 20th century the USA, having achieved a high degree of economic independence, threatened to jeopardize Great Britain's position in the world economy.

3. THE FIRST WORLD WAR AND THE POSTWAR YEARS

The rise in the world economy and trade was hindered during the war years. War conditions halted the previous expansion of international investment and business. The world economy, capital flows, investment, labor force migration, production, and trade were all interrupted.

Analysis of the world stock of FDI in 1914 by country of origin shows a high concentration in Great Britain, of almost half of the total (Table 2). Great Britain, the USA, and the Netherlands together had 2/3 of the total. Enterprises from Great Britain, Germany and France were the largest European investors. Analysis by region shows that companies from Western Europe had 4/5 of the world FDI in 1914.

Table 2. Share in the world FDI stock by country of origin, 1914

Country	Share (%)
Great Britain	45
Germany	14
USA	14
France	11
Netherlands	5
The rest of Western Europe	5
The rest of the world	6
Total	100

Source: Dunning (1993), p. 117 and Jones (1996), p. 30.

Analysis of the distribution of the world stock of FDI in 1914 by host country (Table 3) shows that it was widely dispersed around the world, although it originated in a small number of countries. Latin America and Asia were especially important recipients of FDI. Some of the countries in these regions were very attractive FDI destinations. Brazil, Argentina, and Mexico were the largest recipients of FDI in Latin America, while India and China received the largest share of FDI in Asia. However, the largest individual recipients of FDI were not developing countries but the developed economies of the USA and Canada.

Table 3. Share in the world FDI stock by host country, 1914

Country	Share (%)
Latin America	33
Asia	21
USA	10
Canada	6
Eastern Europe	10
Western Europe	8
Africa	6
The rest of the world	6
Total	100

Source: Dunning (1993), p. 118 and Jones (1996), p. 31.

Analysis of the estimated sectorial distribution and orientation of world FDI in 1914 indicates the immense importance of natural resources to international business at that period (Table 4). Estimates show that at least 3/4 of world FDI and business operations were in the exploitation of natural resources. Considerable investments were made in financial, insurance, transportation, and other services that facilitated international trade in raw materials and food. This sectorial distribution of FDI to a large extent determined its geographical distribution. Investment in industrial production was heavily concentrated in Western Europe and North America, while developing countries were the largest recipients of FDI in natural resources and services, although the USA, Canada, and Eastern Europe also received a considerable amount.

Table 4. Estimated sectorial distribution of world FDI, 1914 (%)

Country	Share (%)
Natural resources	55
Services	30
Industrial production	15
Total	100

Source: Jones (1996), p. 32.

A change in enterprises' sectorial investment orientation is noticeable. Companies that crossed national borders did not hesitate to cross borders between different sectors of the economy: production, services, and natural resources. Through the process of vertical integration, production companies expanded their operations to distribution, oil companies to freight forwarding, distribution, and production, and trade companies to exploitation of natural resources and production.

The First World War hindered almost all aspects of the world economy developed over the preceding 50 years. The postwar economy faced new problems and instabilities. It was hit by several recessions shortly after the end of the war, followed by the Great Depression at the end of the 1920s. However, the links with the pre-war economy were sufficient to provide a favourable FDI climate. While countries such as Great Britain and Japan experienced considerable difficulties adjusting to the new economic circumstances, rapid industrialization took place in countries such as the USA, Australia, Canada, Brazil, and India. In developed countries, industrialization implied further development of industries such as car manufacture and chemicals and a rise in mass production, and in developing countries it implied a rise in the production of textiles and other consumer goods. In both cases, internationally oriented companies found new business opportunities. World trade recovered in the 1920s: by the end of the decade the ratio of world trade to world GDP was back to the level of 1913.

Transportation and communications continued to improve, but the innovations were less radical. The expansion of railways facilitated access to new markets and exploitation of natural resources, and advances such as the opening of the Panama Canal in 1915 further reduced the duration and cost of sea transportation. These improvements were highly beneficial for international business and investment in natural resources. Enhanced transportation stimulated production growth in mining areas of the developing world by reducing the shipping costs of ore and metals to the main markets in Europe and North America. The invention of the telephone and automobile and the rapid expansion of air transportation during the interwar period created new opportunities for international business activities and provided a new tool for management to control remote business operations.

The First World War brought about control over capital flows and a higher degree of protectionism. Restrictive measures were introduced which deviated from the smoothly running pre-war integration mechanism. During the interwar period, which covers the Great Depression, direct and indirect control of international financial transactions was introduced,[11] which posed a large obstacle to international capital flows. This period saw a rise in protectionism. US tariffs had reached an all-time high by the 1920s. Countries such as Australia, India, and some Latin American states introduced tariffs, import quotas, and other trade barriers to help their young industries to grow and to stimulate their manufacturing industries via import substitution. In the 1920s many countries imposed further restrictions on foreign companies, though they were less severe than in succeeding decades. The Soviet confiscation of foreign property after the Russian Revolution of 1917 was far more serious and constituted the first serious attack on international property rights.

The level of international capital mobility started to fall in the 1920s. The international monetary system was seriously disrupted by war inflation and the

[11] Direct control implied a ban on international transactions, and indirect control primarily referred to trade measures intended to stimulate exports and reduce imports.

suspension of the gold standard. Although many countries returned to the gold standard in the mid-1920s the financial and economic environment was very different from before 1914. Capital flows were often speculative and temporary. The war turned Germany from major creditor into a debtor, while the USA became the world's largest lender. New York became the world's main financial hub. On the other hand, Britain's position as international creditor was weakened by war, confiscation of foreign property during the war, and by poor export performance later on.

The postwar years were characterized by a rise in inflation and inflationary pressures in many countries and free fluctuation of exchange rates followed by foreign exchange dumping. Thus from 1920 a new business environment was created, with few business opportunities and threatened by the specific circumstances of the interwar period. The attempt to restore the gold standard by introducing the gold-exchange standard and gold bullion standard failed and the gold standard was abandoned in 1936.

The war years and postwar period brought considerable changes in investment flows and business activities. A rise in foreign exchange risk, liquidity risk, and legal and regulatory risks gradually reduced the share of portfolio investments in total foreign investments in favour of FDI. Direct investment took primacy over portfolio investments due to the lack of effective risk management mechanisms and poor portfolio structuring in postwar years.

The consequences of the war and the war devastation hindered international business operations and caused considerable changes in FDI flows. The USA emerged as the world's largest direct investor, though the US stock of FDI was much below its European counterpart. US FDI almost doubled in the 1920s. This increase more than compensated for the war-driven collapse of German FDI, almost all of which was banned or confiscated. Confiscation of foreign capital in Russia after the Russian Revolution of 1917 caused a heavy loss of French and Belgian FDI. While Russia became an undesirable destination for FDI, FDI inflow to Canada grew rapidly.

The postwar period saw considerable changes in the origin of FDI, while the structure of its recipients remained almost unchanged. Great Britain remained the world's largest direct investor. However, the structure of FDI by country of origin changed considerably relative to 1914. German FDI fell sharply, and the relative importance of the USA increased. Britain maintained its dominance thanks to its historical position, but during the interwar period the USA outperformed Britain in new business activities and FDI. The Netherlands was the third largest direct investor because its stock of FDI remained unchanged thanks to Dutch neutrality during the First World War. Great Britain, the USA, and the Netherlands had more than 3/4 of world FDI. Developing countries remained the largest recipients and Canada and the USA remained the largest individual recipients of FDI.[12]

Significant changes in sectorial distribution and investment orientation of firms occurred at that time. There was both new investment and disinvestment in foreign production. Within the manufacturing sector, distribution of FDI was uneven. The petroleum industry received a considerable share of new FDI. In the service industry, investment in trade was significant, while investment in international banking stagnated. Sectorial distribution and investment orientation was changing, with a decreasing level of FDI in exploitation of natural resources, because foreign investors were losing ownership of production facilities in many developing countries, and a rise in FDI in manufacturing.

According to estimates[13], the world stock of FDI after the First World War, i.e., during the interwar period, totaled USD 26,350 million by 1938.

The postwar years brought changes in international investment and business operations. Postwar developments slowed the total flows of FDI and the expansion of international operations. Companies changed their business strategies, cooperating with competitors in order control markets, which led to expansion of international cartels.

Economic crisis, high unemployment and, in 1929, the Great Depression characterized the business environment of the period and there were few business opportunities in the world economy. Some companies had so many difficulties in domestic markets that they had to withdraw from international operations. The economic environment encouraged companies to join international cartels, which enabled them to fix prices, production, and market share without running the risks involved in FDI. While many industrialized countries faced massive unemployment in the 1930s, the main reason for establishing cartels was falling prices of primary products in Latin America, Africa, and Australia, which caused a sharp drop in producers' real incomes.

During the postwar period the world economic crisis and the introduction of restrictive immigration policies in some countries, primarily the USA, caused a considerable slowdown in international migration. The average annual emigration from Europe dropped from 1.5 million in 1909-1914 to 700,000 during the 1920s and only 130,000 in the 1930s. In spite of restrictive interwar immigration policies and the drop in the number of immigrants, the USA remained the top immigrant destination with the largest number of immigrants, followed by Argentina, Australia, Canada, and Brazil.[14]

In the 1930s the level of international capital mobility fell, there was a rise in protectionism, and the treatment of foreign companies deteriorated because

[12] Jones (1996), pp. 42-43.
[13] Dunning (1993), p. 117.
[14] Kenwood and Lougheed (1971), p. 180.

of conflicts in developing countries between host governments and foreign companies exploiting natural resources. There were major conflicts with the petroleum industry. In 1938 foreign petroleum companies in Mexico were nationalized without any compensation to defend national sovereignty over natural resources, which constituted an attack against international property rights. While the political environment for FDI was deteriorating, governments often supported cartel agreements, which negatively affected FDI flows.

International capital flows fell sharply in the 1930s. The beginning of the Great Depression was accompanied by the collapse of the global monetary system. In 1931 there were serious financial crises across Central Europe and Germany. Britain was forced to abandon the gold standard in September 1931, followed by the USA two years later, which led to its complete breakdown. The gold standard was replaced by a number of regional currency blocs,[15] all of which were under extensive foreign exchange control. In this environment, international capital flows fell sharply and were often limited to currency blocs. All this had a considerable impact on international business. Foreign exchange control was the main obstacle to new FDI, because investors were unable to repatriate dividend payments and profits.

The rise in protectionism continued throughout the 1930s. US tariffs rose significantly, and other countries followed suit. Almost half of world trade was subject to customs restrictions by the end of the 1930s. Tariffs led to foreign companies undertaking FDI to establish local production operations and thus overcome this obstacle.

Further innovations in transportation and communications during the 1930s did not trigger any major FDI flows or expansion of international business operations. Air transportation became faster, safer and more regular. Transatlantic and transpacific services were improved. This facilitated management control over cross-border subsidiaries, but did not encourage any major FDI flows or expansion of international business because foreign investors encountered many political, regulatory and legal obstacles abroad.

4. CONCLUSION

This paper has presented and analysed changes in international business operations and investment flows before, during and after the First World War, based on macroeconomic developments and the overall environment and considering the relevant circumstances, conditions, and factors influencing these changes.

[15] The US dollar bloc comprised Latin America, the sterling area included most of the British Empire and some Northern European countries, the German bloc covered parts of Central Europe, the yen area included parts of Asia, and the remaing 'gold bloc' comprised France and some other Western European countries.

Analysis has shown that the period before the First World War was characterized by one of the greatest expansions of the world economy, including unprecedented levels of international trade, foreign direct investment, and migration. Between the 1880s and the 1920s the importance of international business to the world economy was so great that it took a long time to reach it again. The business environment and macroeconomic developments before the First World War enabled a sharp rise in international investment and business expansion. This period saw a growth in world economy and trade, followed by an expansion of capital flows, investment, labour force migration, production and trade. Flows of trade, manpower, and capital created the first real global economy in human history.

This internationalized world encountered its first obstacle in World War I and its consequences. The war brought about uncertainty, a slowdown in economic activity, and obstacles to international investment and business operations.

The level of international investment and business operations fell considerably after the First World War. Great Britain, France, and Germany, the world's largest investors before the war, were hit by war devastation and costs, significantly reducing the outflow of foreign investments. Great Britain was much weakened, which led to a decrease in capital outflow while the inflow of investments increased. However, Britain remained the world's leading investor for some time after the First World War due to its earlier investments. The position of France was also weakened. Germany found itself in the most difficult situation, becoming exclusively a recipient country of FDI. At the same time the position of the USA changed significantly, becoming the second largest foreign investor after Great Britain, and then taking over Britain's position as the world's leading investor.

The flow and orientation of direct investment abroad and the nature and orientation of international business changed over time. Before the First World War, FDI and business operations were heavily concentrated in the exploitation of natural resources, but in the changed business environment after the First World War the focus shifted to manufacturing. Most FDI originated in a small number of developed countries, but it was widely dispersed, mostly to developing economies.

After the First World War, in the 1920s, there was a modest recovery in international investment and business. However, at beginning of the Great Depression international capital flows and new investments were halted, except for repatriation of capital to home countries.

After the First World War the gold standard was restored, which led to the misleading impression that a major precondition for postwar economic recovery had been fulfilled. However, the fact that the new economic environment was very different to the one on which the success of the pre-war international monetary system had been based and that a shift of economic power had occurred was neglected.

It can be concluded that the development of international investment activities and international business before, during and after the First World War was complex and influenced by many factors, and took place under an array of circumstances – from peace and liberalism to war, crisis, and protectionism. Trends in FDI flows and international business expansion were affected by various interconnected factors, circumstances, and conditions: the macroeconomic environment, treatment of foreign companies, the degree of protectionism, control over capital flows and technological advances in transportation and communications. The postwar years did not bring stability to the world economy. Shocks, instability, and economic depression continued, followed by the Second World War.

REFERENCES

Dunning, J. H. (1993), *Multinational Enterprises and the Global Economy*, Addison-Wesley Publishing Company, England.

Hirst, P. and Grahame, T. (2003), *Future of Globalization*, Handbook of Globalization, Edward Edgar Publishing Ltd.

Jones, G. (1996), *The Evolution of International Business: An Introduction*, Routledge, London and New York.

Kenwood A.G. and Lougheed A.L. (1971), *The Growth of International Economy 1820-1960*, George Allen and Unwin, London.

Rakita, B. (1993), *Međunarodni marketing*, Ekonomski fakultet, Beograd.

Sodersten, B. (1985), *International Economics*, Macmillan.

Stojadinović Jovanović, S. (2008), *Transnacionalizacija međunarodne trgovine*, Prometej, Beograd.

Chapter 6

Causes and Consequences of the First World War: The Agony of the Laissez-Faire

Aleksandra Prascevic*
E-mail: alja@ekof.bg.ac.rs

Abstract: The period after the First World War was crucial for the at least temporary abandonment of the dominance of the laissez-faire concept in economic theory and policy. The World War brought about huge political, economic, and social changes in the world, including changes in the dominance between the most important industrial nations. In the first two decades after the war most economies struggled with problems in public finance (huge budget deficits), followed in some of them by inflation (Central European countries), and with monetary policy that was no longer limited by the gold standard, due to its suspension during and in the years immediately after the war. The return to the gold standard with pre-war parity was wrong for both economic activity and employment, especially in the economies with overvalued currencies such as Great Britain. The need in European countries for industrial and infrastructural capacity and the reconstruction of facilities demanded significant credit injection and a more important role for the government in guiding economic activity. The economic system based on laissez-faire policy making was in deep trouble, indicating that the golden age of the liberal concept was over and that a new economic policy was needed, with emphasis on fiscal policy as the best method for improving employment and effecting economic activity. At the same time, intellectual advocates of laissez-faire (neoclassical) economic theory faced significant criticism. Beyond questioning methodological and theoretical issues of neoclassical orthodoxy, most critics questioned the neoclassical view that the market system, based on private motives, acts harmoniously with optimal results, and consequently that laissez-faire is the best government policy. The key opposition to mainstream economic theory came from heterodox economic thinking, particularly the American institutionalists (non-Marxian heterodox economists), the Austrian school, and the underconsumptionists, the most prominent of who was J. M. Keynes. The focuses of economic analysis also changed. Macroeconomic issues gained importance, which resulted in the birth of modern macroeconomics, with the Keynesian revolution at its heart. Such radical changes in economic thought meant that although the economic situation was bad in most European economies, economic theory improved significantly during the interwar period.

Key Words: Laissez-Faire Concept, World War I, Macroeconomics

JEL: B12, B13, B22

---

* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179065) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

1. THE GOLDEN AGE OF THE LAISSEZ–FAIRE CONCEPT: THE CLASSICAL AND NEOCLASSICAL PERIODS

The laissez-faire concept, as developed in economic theory and widely applied in economic policy, has its origin in economic trends in Britain in the second half of the 18th century, and especially in the economic and social factors that determined the dynamic and rapid development of the Industrial Revolution. The father of this idea was the British economist Adam Smith (1723-1790), who in his book *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776)[1] established a causal series of factors that determine the wealth of a nation (i.e., its economy). According to Smith, these factors are universal, although it was clear that they were primarily suited to the economic development of Great Britain in the late 18th century. Thus began the Classical Period (1776-1890) in economic thought, almost exclusively linked to Britain.

During the fifty years after 1776, technical progress in Britain resulted in a dramatic increase in the production of goods[2]. Economic development driven by technical and technological progress marked the coming centuries. Instead of the mercantilist concept of the pre-classical period in the development of Western European commercial capitalism, which included a decisive role for the state and its ruler, economic nationalism, and state planning in the economic sphere, in the countries where the classical ideas emerged the economic conditions required change in order to stimulate the economic freedom of individual economic agents, reducing the role of the state and advocating universal economic laws and universal economic policy, which was essentially liberal.

Thus, as with mercantilism, classical theory emerged and developed in a specific economic and historical context[3]. "And it was the good fortune of Adam Smith to completely agree with the atmosphere of the times. He advocated the things that were already on the horizon, and his analysis should have served them. It is not necessary to insist on how important it was for accomplishment and success: where would *The Wealth of a Nations* be without free trade and *laissez-faire*?"[4]

The key assumption of classical political economy as formulated by Smith is that production creates value and determines the wealth of a nation - the amount of goods and services produced in an economy. Production is left to individual economic agents who have a personal interest in it and are motivated by profit

[1] Which, in terms of its success and influence, Schumpeter considered the most influential scientific book, comparing it only to Darwin's *On the Origin of Species* (1859) (Schumpeter 1975, p.150)

[2] James Watt's patented the steam engine in 1769. It was soon introduced into textile manufacturing (1790s) so that by 1800 there were hundreds of steam engines in British factories (Hughes and Cain, 2007, p.74).

[3] Economic science has an important historical dimension, resulting in greater contextuality of certain schools of economic thought. (Roncanglia (2006), p.13)

[4] Schumpeter (1975), p.153

maximization, and who are characterized by rationality, so that they are guided by the "invisible hand of the market" and no longer by the "visible hand of the state". This rational behaviour of atomized economic agents not only enhances their individual economic well-being but also increases the well-being of the entire nation (economy) and results in the increasing wealth of nations. Through the concept of natural liberty Smith talks about a state policy that removes all restrictions (other than those relating to 'justice'), enabling the free action of individuals, whose free interaction does not result in chaos but in a logical and consistent model (Schumpeter (1975), p.153).[5]

The advocacy of laissez-faire was the strongest in Britain, from where it naturally spread to the United States. However, a more detailed analysis of the economic policies and business practices in these two economies over the following centuries indicates that in fact laissez-faire policy allowed for the selfish and heartless behaviour of businessmen intent on achieving their own selfish interests free from any restrictions by the state. In practice the economic policy of the state still played a very important role, especially in the USA where, despite the development of a very cruel type of capitalism, there still was "a unique blend of government and private enterprise"[6] that was based on a pragmatic combination of individual freedoms and interests on the one hand and the needs of the society and the state on the other[7]. This so-called 'American system' regarded government as an agency to assist individuals and private enterprise in order to hasten the development of the nation's material resources.[8]

Liberal ideas and economic policy never achieved the success in continental Europe that they had in Britain, despite having supporters: mainly because these economies had not yet reached the same level of development, and because in the many European countries that were devastated by wars and territorial conflicts the state maintained a key role in the economy. In these countries, laissez-faire was often perceived as another British attempt to impose its power and hegemony on others who had not yet reached its level of economic development[9]. An example of such an opinion is the German historical school.

---

5 The year The Wealth of Nations was published, 1776, is also the year of the American Declaration of Independence, so this book was really an expression of the need for the release of individual freedoms through the system of 'natural liberty' which Smith proclaimed, and which immediately received great public support.

6 Cameron and Neal (2003), p.211

7 Until the Civil War, federal government had no significant economic role, following classical theory and liberal low-tariff policies; however, local government played an important role in promoting economic development.

8 Cameron and Neal (2003), p.211

9 Britain was seen as the "factory of the world".

The historical school[10] did not agree with classical economic policy and revived the idea of economic nationalism and the institutional organization of the state. Instead of the invisible hand of the market, one the leading figures of the German historical school, Friedrich List (1789-1846), in his famous book *The National System of Political Economy* (1841), argued that the laissez-faire economic policy advocated by British classicists was wrong for economies at a lower level of development than Britain. He advocated an active role for the state in international trade, through various forms of protection of domestic national production (primarily industrial) for countries that were far below British levels of development, such as Germany and the United States. List lived and wrote his most important work in America and was influenced by American economic practices and thought; he was particularly impressed with the implementation of measures to protect young American industry. His book was warmly received in America and he is considered the father of American protectionism[11], although he was actually concerned with the national position of the German people.

Both the German historical school and American economic policy required some essentially mercantilist measures. American economic thought was significantly influenced by the historical school through List, and continued to develop under their influence, primarily through the ideas of Thorstein Veblen and institutionalism. In 1791 Hamilton's *Report of Manufacturers* appeared, in which he advocated the protection of American manufacture from competition from the more developed British industry. This prompted List to conclude that economic development can not occur spontaneously, but requires state intervention in the form of a legal framework, state administration, and foreign policy, and primarily that the nation be unified and powerful (List, 1841 [2005]).

In contrast to the development of economic thought in Germany and, to some extent, in the United States, in other countries the classical laissez-faire concept was further developed in the neoclassical period, including in Britain, were economic thought was influenced by the theory of Alfred Marshall. The neoclassical revolution occurred in the 1870s, opening the door to the development of microeconomics. The ideas of classical political economy that depended on the rational 'homo economicus' were further elaborated in the neoclassical period through insistence on microeconomic behaviour as crucial for both microeconomic and macroeconomic results. (Jaksic and Prascevic, 2007).

---

[10] Historicism, as a direction in philosophy, was the key alternative to rationalism, with Hegel (1770-1831) as one of its most important proponents. Much as rationalism affected classical political economy, primarily British, historicism had its effect in the development of the German historical school of economic thought. Starting from the idea that it is necessary to consider each particular historical circumstance, and that universal laws and principles that would be valid at all times and in every place are almost non-existent, representatives of the historical school of economics opposed the classical method (abstract theoretical deduction) and the non-contextual established economic laws, which, according to classicists, were universal (in terms of both time and space).

[11] This is considered to be the influence of Hamilton.

Neoclassicism changed the subject of analysis by focusing on microeconomic topics instead of macroeconomic issues related to the wealth of nations (economy), distribution of income, and the rate of economic growth. Microeconomics was related to consumer behaviour, which was determined by marginal utility as the basis that determined value, or the price of the product. Another subject of analysis was the allocation of scarce resources in competitive markets, and the neoclassical school solved the issue of the distribution of income to the factors of production, which was problematic for classicists, by the ultimately objective theory of the marginal productivity of factors. Thus, in the neoclassical school there was no room for the question of the wealth of nations (economy) and the factors that determine it, and the supreme axiom of neoclassicism became the idea of a rational 'homo economicus', led by the invisible hand of the market. In the development of economic thought, neoclassical theory followed Smith, not the other influential representative of the classical political economy, David Ricardo.

In neoclassicism there was no room for contextualization - the influence of institutional factors and historical processes and circumstances. The focus was on the individual, not the group, whether social class or nation. The behaviour of the individual was regarded as universal and independent of both time and place and was the basis of the abstract deductive model of consumers (households) and producers that formed the basis of modern microeconomic theory and the neoclassical approach that dominated economic theory for almost the whole of the 20th century, with its focus on market solutions and rational, calculating, and utilitarian individuals concerned with efficiency. Institutional context and the historical dimensions of economic analysis were pretty much ignored. (Chavance (2009), p.1)

2. RAPID DEVELOPMENT AND DISPARITIES IN DEVELOPMENT AS CAUSES OF THE WAR

British economic success, which was the source of its political and military power, is attributed to the success of laissez-faire ideology, industrialization, and commitment to free trade. Thus before the First World War there was no serious alternative to the laissez-faire concept in economic theory. Yet its application (even though it had never been fully applied even in the countries which advocated it most) contributed greatly to the increasing disparities in economic development between countries. These differences were obvious in European countries, in particular the three most industrially advanced economies, Britain, Germany, and France, and in the European 'periphery', which included the countries of South and Eastern Europe. On the other hand, the rise of the United States' economy at the end of the 19th century augured the end to the European century, and the equal, if not greater, importance of non-European countries in economic, social, intellectual, and scientific development in the 20th century.

Consideration of the causes that led to the start of the First World War requires an analysis of the global economic trends in the period that preceded it, when a period of rapid economic development led to an imbalance in economic and political power between the important European countries

On the eve of the war Britain, as 'the first industrial nation', was the most economically developed and richest country in the world, with outstanding military and political power, the leading colonial power (with an empire of 345 million people), and the global financial centre. Since the 1880s, however, it had faced strong competition from the newly industrialized countries, primarily Germany and the USA, whose industrial production had surpassed Britain's (the United States in the 1880s, Germany in the early 20th century). This was particularly true in terms of the development of new economic sectors. Britain remained the leading commercial nation, but with a significantly smaller share in world trade than before (towards the end of the Napoleonic Wars Britain had a quarter to a third share of international trade: this had decreased to a sixth). It was still supreme in the key sectors of the British economy -textiles, coal, iron, and engineering - although the United States and Germany were catching up.[12]

Britain, however, recorded increasingly lower growth rates. It reached its peak in 1850-1870: in 1856-1873 the growth of gross domestic product grew on average by 2.5%, lower than in the earlier period as well as relative to its key competitors. This suggests that British economic growth had slowed down significantly and the rates that it had during the 18th century and the 1870s were a thing of the past. However, in the period 1850-1914 the real per capita in Britain increased about 2.5 times, income distribution became more equitable, the percentage of the population living in deep poverty was reduced, and living standards were higher than in other industrialised countries.[13]

Despite the slowdown in the British economy at the end of the 19th century the global economy grew significantly due to rapid scientific developments. In the period 1890-1913 industrial production in Europe more than doubled as a consequence of growth in the chemical and electrical industries, which contributed to the development of already existing industries such as metallurgy and engineering. Particularly important was the building of hydroelectric power stations, which alleviated the position of countries without coal. Electricity facilitated the expansion of telephone traffic in Europe, and the appearance of the car was revolutionary, as was that of aircraft, which had both civilian and military uses. The already existing modes of transport were also modernized; the railways were electrified in

[12] Cameron and Neal (2003), pp.221-223

[13] Ibid.

the early 20th century. All this contributed to economic growth in the European economies peaking between 1900 and 1913, when European GDP grew by 27%.[14]

Germany recorded the most rapid growth before World War I. It was the last of the major European countries to become industrialized: in the first half of the 19thcentury it had been a backward agricultural area without industrial production or a developed transport infrastructure. Political disunity was a significant problem: it consisted of a number of states with different monetary systems and trade policies that restricted trade with each other. This first phase of development lasted until 1833, when a tariff union was formed, which represented the first step towards the economic unification of Germany. The second phase of development lasted until 1870-1871 and was characterized by rapid industrialization and increasing domestic and international trade. The third phase began with political unification and the creation of a new Second Empire in Germany, which lasted until the beginning of World War I. During this period Germany recorded phenomenal growth and development, making it the most powerful industrial nation in Europe by the beginning of the war with the largest and most modern production of iron and steel and their products, electrical power, machinery, and chemicals. In the production of coal Germany was still behind Britain, but was becoming a leading manufacturer of glass, optical instruments, nonferrous metals, textiles, and other manufactured goods.

Germany's unprecedented rapid economic development was the result of many factors, one of which was foreign influence. In the first phase of development this was reflected in the ideas of the French Revolution, and of the impact of the Napoleonic wars; in the second stage in the inflow of foreign capital, technology, and enterprises; and in the last period in the expansion of German industry into international markets.[15] All of these developments were influenced by economic policy and the substantial transformation of German society, which became more urban during the 19th century. However, the most important factor was probably the new industrial revolution in Germany and the United States.

The development of science and new technology-intensive industries'[16]was the secret of German success, enabling it to become the leading technological power, with an industrial structure that was considerably more modern than in other European countries. Germany did not face the problem of out-dated technology, as was the case in Britain. The most important industrial sector was heavy industry, the production of coal, iron, and steel (in 1913 it produced three times more steel than France, and two times more than the UK), not the textile industry: towards the end of the 19th century heavy industry in Germany was extremely developed and double that of consumer goods. German production of electricity was higher

[14] Berend (2013), pp.15-20.
[15] Cameron and Neal (2003), p. 238
[16] Berend (2013), p.25

than in Britain, France, Italy, and Sweden combined. The same is true of the chemical industry, which was dominated by German production (one third of global sales of chemical products were German, German chemical output was 60% higher than the output of the United States, and as much as five times higher than Swiss output, which was second in Europe). Another factor that contributed significantly to German industrialization was its education system, which paid special attention to the technical education of workers and engineers. The best indicator of how much the German economy grew is the 32% increase in per capita GDP in the period 1897-1913.

Before the First World War the global economy was still dominated by the European economy as the world's banker with 46% of world GDP and 41% of global GDP per capita, as well as 90% of total international capital exports. Yet a consideration of the economic trends that preceded World War I requires an analysis of another fast-growing economy, America, which became a significant competitor of European economies, with an industrial output in 1913 that was almost equal to that of all Europe[17].

Throughout the 19th century the United States was the most obvious example of the rapid growth of a national economy. The population increased from 4 million in 1790 to 100 million in 1915, and income and wealth grew even more. Both before and after becoming an independent country, America largely followed Britain in the application of inventions necessary for the development of industry. This applies particularly to the development of the cotton industry, which was its leading industry until 1860. The same can be said of the transport infrastructure. Railways were built in the United States at the same time as in Britain, and already in 1840 the total length of railroads in America exceeded the total in Europe, although the United States remained dependent on imported British technology, equipment, and capital for a long time. Over time, the United States developed intensive heavy industry, especially after the Civil War, when the steel industry became the most important industry. The United States also owed their remarkable economic rise to important geographical factors: vast lands and natural resources. Large territory provided the opportunity for unimpeded settlement, which, together with relatively high wages and political and religious freedoms, made America a very attractive country for immigration. Unlike in Britain,[18]before WWI most of the population was still involved in agriculture, so the United States remained a rural nation for a long time. However, from the 1880s on, the non-agricultural labour force was larger than workers in agriculture, and the income generated by industry surpassed that of agriculture. Thus, from the 1890s the United States became the world's foremost industrial nation[19], as evidenced by comparative data on GDP growth.

[17] Hughes and Cain (2007), p.208.
[18] Hughes and Cain (2007), p.339.
[19] Cameron and Neal (2003), pp.224-227.

Already in the 19th century it was possible to talk about different types of capitalism in different countries, although what Schumpeter defined as international "bourgeois culture", based on middle-class values, culture, and ideals developed during the period 1842-1897, was the backbone of almost all capitalist countries. This culture included a system of liberal representative democracy, personal freedom, access to education, tolerance of diversity, and the protection of property rights. However, although Schumpeter spoke of their universality, they had different manifestations in different countries. Their basis was the capitalist entrepreneur who was willing to risk new products, new ideas, new services, and new technologies in competitive markets. Nineteenth century industrialization was effected by entrepreneurs, individuals who created new businesses. This was especially true in the United States, where entrepreneurs played an extremely important role and were highly appreciated. The American capitalist system, unencumbered by historical legacies, whether of economic systems or national frameworks, provided the opportunity to develop big business and a society based on profit and gain, which led to economic growth but was also criticised, primarily by the American institutionalists.

Political factors conditioned America's rapid economic development and economic policy in the period before World War I, just as international political relations conditioned the economic positions of all the capitalist countries. Although pre-WWI international relations can not be compared with those that existed during the first phase of the development of capitalism and the emergence of nation-states, or with the markets during the mercantilist period from the 1500s to the mid-1700s when there were permanent wars between the countries with short periods of peace, the relationship was still characterized by conflict and the race between the leading European countries for the conquest of new colonies.

The First World War broke out in Europe and was primarily 'European', although it also involved non-European countries. It was caused by the disparity between economic power and political positions and the dominant countries' attempt to change the balance of power. Before 1914 the Western European Nations (the British, the French, and the Germans) and the United States had a dominant role in international relations. Economic growth and prosperity in Europe was significant but uneven, and these disparities together with the inability of European countries to agree on changes in the world order were decisive to the outbreak of the war. There were obvious differences in economic growth rates between the 'old' industrial European countries and the 'new' ones, including non-European countries. In addition to the slowdown in the British economy, among the old powers the behaviour of the French economy was particularly interesting. It managed to keep pace with its competitors (with a32%growth of GDP per capita in the period 1897-1913), remaining in third place in Europe behind Britain and Germany in terms of total industrial production, while industrial production per capita lagged behind both Switzerland and Belgium. By contrast, it had significant political power on the old continent, with aspirations to maintain its leading position along with the United Kingdom and to prevent Germany from usurping its position by all means possible.

The countries of Southern and Eastern Europe - the so-called 'European periphery' – were even more drastic examples of uneven European development. Although they applied the laissez-faire concept and the Western model of economic policy, these countries failed to reach the level of development of the Western and Central European countries. This was particularly true for the Balkan economies, which remained predominantly agrarian (75%-80% of the active population), with low industrial production, low GDP per capita, and low rates of economic growth (most Balkan countries had negative growth rates).

Table 1. GDP per capita ($1990 ppp)

Year	Central & Eastern Europe	%	Southern Europe	%	Western Europe	%
1870	1,085	100 79	1,108	100 70	2,110	100 68
1900	1,373	127 100	1,572	142 100	3,092	147 100
1913	1,690	156 123	1,750	158 111	3,704	176 120

Source: Berend (2013), p. 39

Table 2. GDP per capita disparities between European core and peripheries

Year	Western Europe	Southern Europe	Eastern Europe
1820	100	62	60
1870	100	53	51
1913	100	47	46

Source: Berend (2013), p.39

Thus, the laissez-faire model failed to generate corresponding industrialization in the Balkans or in other peripheral countries. The optimistic and enthusiastic belief in the laissez-faire system's omnipotence and temporal and spatial universality in providing economic results was not born out in economic developments. This paved the way for state intervention, and imposed many challenges. Therefore, it is not surprising that the Great War began in the territory of the European periphery, and that during this war the Bolshevik October Revolution led to far-reaching changes and the creation of a new economic system. The Russian Revolution is an example of the diverse political trends of the period, from class movements to Balkan nationalism as the expression of many centuries of aspiration to become independent and free from the yolk of empire, whether Ottoman or Austro-Hungarian. These movements fully tested the European political and economic system of parliamentary democracy and a free market economy, rejecting the laissez-faire system and the values it was based on (the decisive role of the middle class, personal freedom, capitalist individualism, and 'selfish materialism'). Together, the First World War and the October Revolution can be considered as a crisis of the laissez-faire system.

3. UNSUSTAINABILITY OF THELAISSEZ-FAIRE SYSTEM AFTER THE FIRST WORLD WAR

If the historical, economic, and political conditions abetted the laissez-faire system and its dominance in the 'long 19th century' (1870s-1914), the First World War represented a turning point in the dominance of the laissez-faire concept, both in economic theory and in economic policy. After the war European economies abandoned the laissez-faire system and free trade and turned to state intervention, a regulated market system, economic nationalism, and protectionism. Economic problems indicated that earlier principles of economic policy were unsatisfactory, and that change was necessary. However, this did not automatically mean that policymakers and academic economists knew what should replace the old economic system and the extent to which such changes were necessary. The changes had to occur in the framework of an economic theory that could provide a basis for the implementation of new economic policies, a theory that could explain the economic problems that had occurred as a consequence of the World War in a way that neoclassical theory had failed to do. This was by no means easy, nor is it possible to identify a single step in which the change occurred. There was rather an entire period in which key elements of the laissez-faire system were gradually questioned, and gradually abandoned, step by step.

At the end of the First World War neoclassicism dominated economic theory, insisting on universal market solutions and rational economic agents that operate in markets of perfect competition, whose preferences and motives are universal and never influenced by contextual factors, with no differences arising from membership of a particular group, whether it be social class or nation. The extremely unrealistic assumptions of neoclassical theory were not very helpful in resolving the emerging and increasing economic problems and a completely new theoretical concept of the economic system was necessary. This was offered by John Maynard Keynes, a leading figure in British economic theory and policy, who brought about an unprecedented change in economics by designing a new economic discipline, macroeconomics, which would deal with economics as a whole and provide a 'general' view of real economic developments.

This change involved a pains taking effort to shift the focus of research from microeconomic to macroeconomic issues, and the acceptance that the classical idea of the perfect functioning of an economic system is only one possible solution among many. There also exists a 'general' solution, which an economic system, if left alone, will tend to. This solution, however, will not be economically desirable because it will mean high unemployment, recession, and low income levels, which will then require state intervention. This had been demonstrated by the economic developments that culminated in the Great Depression (1929-1933), which originated in what had been a fast-growing economy, the United States, thus confirming that the laissez-faire system was no longer efficient even in the economy where it had produced the best results. State intervention was necessary. In the same way as social and economic conditions in the late 18th century enabled laissez-faire economics and the success of Adam Smith's theory, the inability of laissez-faire economics to deal with the state of the world after World War II facilitated the victory and success of Keynes's economics and state intervention.

The methods and elements of government intervention were at first a great unknown. It was necessary to decide on a variety of changes in monetary and fiscal policies, not just trade protectionism. Developed economies' experience of state intervention in the form of protectionism after World War I had been anything but helpful, as it had only fuelled the post-war chaos. It was because there were no appropriate solutions to economic problems after the First World War that fascist and national-socialistic forces emerged during the 1920s and 1930s, leading to a change in political (the introduction of dictatorships) and economic (extensive state intervention) organization. The failure to find an economic system that would generate adequate economic growth and to establish the necessary international cooperation to build new economic and political institutions were the reasons why the agony of the laissez-faire actually ended in the Second World War, whose end finally marked the creation of a new international economic and political order.

The economic consequences of WWI are often associated with the economic consequences of the peace, meaning that they were caused by both the outcome of the war and the conditions of the peace imposed by the victorious countries. The number of war casualties was unprecedented in human history; around 10 million soldiers were killed and 20 million wounded, and civilian casualties were even more significant; about 10 million people killed in conflict and another 20 million from starvation and disease. The direct material costs of military operations are estimated at between 180 and 230 billion dollars (in 1914purchasing power) and indirect costs (destruction of housing, industrial plants and equipment, etc.) at about 150 billon dollars.[20]

The interruption of economic relations between countries, including the exchange of goods and services and capital flows, had even greater consequences. Trade did not return to normal even after the war, preventing the world economy from functioning freely, as, irrespective of tariff barriers, international cartels, or private monopolies, it rested on market-regulated economic activity, both at the national and the international level. Generally, the war economies had relied on

[20] Cameron and Neal (2003), p.339.

direct control of prices, production, and allocation of resources in order to marshal the vast resources the war required. The end of the war meant the end of this control, but relations did not return to those that had existed before the war.

The war particularly disturbed international trade because the four leading countries, Britain, France, Germany, and the United States, which had previously been important trading partners, had found themselves on opposing sides in the conflict. Immediately after the start of the war, Britain, with its powerful navy, imposed a blockade on German ports, similar to that during the Napoleonic Wars. This limited maritime trade significantly as the British restricted not only German trade but also the trade of neutral countries, and the Germans responded by using their new weapon, submarines, which intercepted not only military vessels. This resulted in the loss of foreign markets, and difficult inflow of raw materials. The German economy was the most affected, but by 1918 British industrial exports had been reduced by half. This led to a change in attitudes at the global level: producers from the United States, Japan, and once-industrially underdeveloped countries replaced European suppliers of finished products. After the war the European countries tried to defend their position using tariff barriers, which restricted global trade flows. While European economies were adversely affected by the war, it marked the beginning of industrialization for some Latin American and Asian countries. A similar thing happened to agricultural production, which experienced its largest expansion in the United States and continued along the same path after the war, although the fall in agricultural prices in the 1920s hit American farmers particularly badly.

Significant changes also occurred in the financial markets and the banking sector. The position of London before the war as the financial centre of the world had been usurped by New York and in some areas by Switzerland, due to its neutrality. European countries were no longer the major global investors, and the United States changed from net debtor to net creditor.

The war ended with the Paris Peace Conference, which, however, failed to provide a solution to the existing problems, which were rather further aggravated by the Versailles Treaty. The Treaty reflected a lack of understanding of the reality and a lack of anticipation of future events and of the inevitable downward trajectory of European economies. The peace conference resulted in increased economic nationalism and monetary and financial problems. There was no agreement on a sustainable international economic and political order that would consider not only the wishes and aspirations of the victorious nations but also their realistic potential, and the potential of the defeated nations. The dissolution of the German, Austro-Hungarian, and Russian empires resulted in the restructuring of major European markets. The newly formed states created by the dissolution of the Habsburg monarchy and from former German territory (e.g., Poland) soon developed nationally oriented economic policies characterized by protectionism, rather than a single economic policy and a single market. Economic nationalism emerged from the centuries-old national aspirations for liberation from foreign occupation in the less developed countries, which immediately became mutual rivals in their desire for faster development.

Economic nationalism and the various forms of new mercantilist policy were also present in the Western European countries and the United States, whose past development and present dominant economic position were based on international trade. In these countries (including Great Britain, the birthplace of laissez-faire), economic nationalism meant significant tariff barriers, import quotas, and export subsidies. The implementation of these protectionist measures in one country led to them being introduced in the next country and so these new mercantilist measures spread across the world. Unlike the mercantilist economic policies that had had a positive effect on development during the 'long 16th century', these measures had negative effects that were completely different from those intended. Rather than leading to economic development and an increase in production and exports, they caused a decline in income and exports and rising unemployment.

The protectionist measures applied not only to industrial production but very often to agricultural production as well. There were two reasons for this: and the huge global surpluses accumulated in the 1920s[21] which led to a global decline in agricultural prices by as much as 30% just before the onset of the Great Depression, and the political power of farmers, which made it easy for them to demand protection of agricultural production from foreign competition. The rise of a regulated market system was also the result of the rise of social democracies in the interwar period. In 1919 social democratic parties won 41% of the vote in Austria and 39% in Germany, and in the 1930s between 46% and 54% of the vote in the Scandinavian countries. In many countries (Germany, Britain, Austria, France, and Sweden) cooperation between trade unions and employers' organizations was promoted through participation in government.

The positive effects of free trade had been very evident in the pre-war period of 1900-1914, the years of the Belle Époque in France and the 'golden age' in Edwardian England, when rapid economic development resulted in a period of great prosperity for the world economy[22]. This resulted in attempts, notably in the framework of the League of Nations, to ensure it reinstatement in the interwar period. With this aim, several conferences were organized by the League in order to promote the return to the free-trade. These attempts unfortunately appeared unsuccessful. During the subsequent Great Depression many countries attempted to save themselves by any means possible and often opted for protectionist measures, which had the completely opposite effect.

[21] In this period staple agricultural production increased by 30%-80%.

[22] Carreras (2006), p. 239

4. MONETARY AND PUBLIC FINANCE PROBLEMS – OBSTACLES TO LAISSEZ-FAIRE

During the First World War almost all European economies recorded a decline in GDP[23]. For the majority of the winning countries the recovery lasted until 1924, by which time damaged facilities and infrastructure had largely been reconstructed, the most important post-war economic and political problems had been resolved, and the period of high inflation was over. Exceptions to this were the UK and Italy, where there was a decline in GDP after the war. The causes were different in the two economies, as were the consequences. In Italy the decline led to the emergence and victory of Fascism, while in Britain there was increased social conflict and pessimism about the future of 'the empire on which the sun never sets' and its position in the global market. The subsequent decisions of economic authorities only deepened these problems and encouraged recessionary trends. However, in most countries a period of recovery until 1924 was followed by a period of quasi-prosperity, which lasted until 1929 when the Great Depression began. During this period the important events were in monetary economics and the financial and banking systems.

The problems in the real economy during and after the war – production, exports, and employment – resulted in high inflation and problems in public finance. These were the key factors that contributed to macroeconomics becoming a separate discipline in economics and that inspired Keynesian macroeconomic theory.

In monetary policy the laissez-faire concept was equal to the implementation of the gold standard, so that the fate of the gold standard reflected the fate of laissez-faire policy (Wolf and Yousef, 2007). The gold standard was based on a quantitative theory of money that was challenged by Keynes, who questioned the key idea of the neutrality of money. It was this Keynesian theory of money that provided a new basis for the conduct of monetary policy. However, the change in monetary policy was neither easy nor quick, and in the meantime most economies paid dearly for sticking to the old orthodox monetary policy principles in the form of falling income and employment and overall aggregate demand, which was considered one of the factors that exacerbated recessionary trends during the Great Depression (1929-33).

During the 19th century and until the First World War the international gold standard was the basis of international integration and economic prosperity. It was dependent on Great Britain and its central bank, the Bank of England, which managed it very well. Officially, the United Kingdom had introduced the gold standard after the Napoleonic wars, although even in the preceding period gold de facto served as the monetary standard, even though the official standard was bimetallic (silver and gold). With the introduction of the official gold standard, the Bank of

[23] Carreras (2006), p. 294.

England made a commitment to exchange monetary liabilities for gold if required, and not to impose any restrictions on the export or import of gold from the country. The gold standard was the regulator of the balance of payments, so that a change in the balance of gold (inflow and outflow of gold from the country as a result of export and import of goods) caused fluctuations in the money supply, and thus a change in product prices. This could lead to significant changes in prices and intermittent inflation and monetary panic. The new German Empire was the second country to officially adopt the gold standard[24], and the United States did so around the same time (1879)[25].

In most countries the gold standard regime was suspended at the beginning of WWI as part of war financing. Britain did so in 1914, with a commitment to go back to the standard as soon as possible with the parity that was in force before the war. The suspension itself can be considered a normal operation of the gold standard, and it facilitated the financing of government expenditures during the war, primarily through the use of "seigniorage" revenue, which would not have been possible under the gold standard. The commitment to return to the gold standard sent a message that the monetary authorities were committed to maintaining the stability of the economic system and a tight monetary policy. It was expected to solve the problem of high inflation that appeared in some economies during the war and the hyperinflation in some middle European countries after the war.

The high costs of funding and waging the war were covered by printing paper money, which lost its value and resulted in inflation, a monetary phenomenon on originating in fiscal imbalance (high budget deficits). There was no nominal anchor because the gold standard was suspended, so there were significant price increases. During the war, prices in Britain increased by 3, in France by about 5.5, and in Germany by 15. Such high rates of inflation had consequences in the form of price distortions and a slowdown in economic activity, impeding trade flows and causing social consequences and costs. After the war policymakers wanted to regain price stability as soon as possible and thereby facilitate are turn to 'normal' for the economy. However, there were two important questions: 1) is the economy ready for the return of the gold standard? and 2) should the currency be devalued or re-valued or should the parity in force before the war be adopted? There was no single answer to these questions and they required a complex approach, given that the war had affected the economies of individual countries unequally. Some post-war economies returned to 'normal' more easily than others. Returning to the gold standard was a different issue for the victorious countries than for those that lost the war such as Germany, which had to pay substantial war compensation. Thus in some countries the return to the gold standard was a political issue.

[24] Bismarck did this when he established the Reichsbank, the Central Bank of Germany, as a monetary institution that would be the sole issuing agency.

[25] It was officially done by Congress in 1900.

Table 3: Dates in Changes in Gold Standard Policies

Country	Return to Gold	Suspension of Gold Standard	Foreign Exchange Control	Devaluation
Australia	April 1925	December 1929	-	March 1930
Austria	April 1925	April 1933	October 1931	September 1931
Belgium	October 1926	-	-	March 1935
Canada	July 1926	October 1931	-	September 1931
Czechoslovakia	April 1926	-	September 1931	February 1934
Denmark	January 1927	September 1931	November 1931	September 1931
Estonia	January 1928	June 1933	November 1931	June 1933
Finland	January 1926	October 1931	-	October 1931
France	August 1926 – June 1928	-	-	October 1936
Germany	September 1924	-	July 1931	-
Greece	May 1928	April 1932	September 1931	April 1932
Hungary	April 1925	-	July 1931	-
Italy	December 1927	-	May 1934	October 1936
Japan	December 1930	December 1931	July 1932	December 1931
Latvia	August 1922	-	October 1931	-
Netherlands	April 1925	-	-	October 1936
Norway	May 1928	September 1931	-	September 1931
New Zealand	April 1925	September 1931	-	April 1930
Poland	October 1927	-	April 1936	October 1936
Rumania	March 1927 – February 1929	-	May 1932	-
Sweden	April 1924	September 1931	-	September 1931
Spain	-	-	May 1931	-
United Kingdom	May 1925	September 1931	-	September 1931
USA	June 1919	March 1933	March 1933	April 1933

Source: Bernanke (2004), p.74

Most countries opted to return to the gold standard and managed to do so during the 1920s (Table 4). This was preceded by a conference on the gold exchange standard in Genoa in 1922. It was there that some principles were established for the functioning of the interwar gold standard, which was different from the gold standard in operation before the war. It was agreed that in addition to gold, which was insufficient, convertible foreign exchange reserves (dollars and pounds) could be kept as monetary base: what, however, was not agreed, was who would manage this system. This would prove to be an important factor in the rapid collapse of the system, and with it the laissez-faire concept of monetary policy. Without economic leadership the international economic system was ruined by poor cooperation between the countries, while international agreements remained only on paper. Economic chaos and increased risk ensued.

Another issue of the parity of currencies returning to the gold standard was much more difficult, and the consequences were significant and far-reaching. An example of this is the return of the British pound to the gold standard in 1925, in line with pre-war parity. Britain, as a leading economic power in the pre-war period, was the pillar of the international monetary system based on the gold standard and wanted to maintain this position after the war. However, real economic developments indicated the groundlessness of this parity and that the British pound would be overvalued, as Britain had lost its position in production and international trade and had experienced high inflation. The pound was overvalued by 10%-20%, which was crucifying the British economy upon the cross of the gold standard with an unrealistic exchange rate of USD 4.86. This unrealistic parity did not correlate with the real power of the American economy, which had emerged strengthened from the war.

Overestimation of the pound increased the cost of British products in the international market and weakening Britain's already shaken competitiveness. The country had to look for opportunities to reduce production costs, which were found by lowering wages. This had a negative impact on macroeconomic developments, as it resulted in a redistribution of income at the expense of the workers and led to strikes and increasing class conflict, making it more difficult to resolve the accumulated economic problems. The return to the gold standard with an overvalued currency, lower wages, and significant unemployment (already a big problem in 1921 with more than 1 million or one seventh of the work force unemployed, reaching 25% during the worst years of economic depression) further reduced consumption and hence aggregate demand, as well as production and employment. The vicious circle of recession-deflation had already begun, and was first pointed out by Keynes in his theory of the neutrality of money, which questioned the concept of strong currency and solid monetary policy as the bases of economic prosperity.

In addition to Britain, 28 other countries had returned to the gold standard by the end of 1925. The Scandinavian countries and Switzerland, like Britain, accepted pre-war parity, while others like France switched to the gold standard gradually or with the help of the Bank for International Settlements, which approved a stabilization loan for Spain. Unlike the British pound, which was overvalued and therefore resulted in reduced economic activity, the French franc was undervalued and fostered economic growth, making France one of the last safe havens of the so-called 'gold bloc'. Returning to the gold standard secured much needed credibility for the economic policy (fiscal and monetary) of Central European countries (Austria, Hungary, and Germany) that had experienced episodes of inflation and hyperinflation.

In most countries public finances were in a bad state immediately after the Great War. The war had been expensive and resources had been reduced and destroyed, causing fiscal revenues to decline and expenditure to grow, firstly to finance military operations and later for reconstruction. The resulting massive public expenditure and debt caused a significant fiscal crisis. In many countries this problem was resolved in the worst possible way: by printing money, which led directly to inflation. Fiscal problems increased due to the political and economic conditions imposed on the defeated countries after the war, which Keynes called "the economic consequences of the peace".

The war also led to a significant increase in debt between countries. In the years 1914-1917 Britain was the main financier of the Allied countries, to the amount of about USD 4 billion. This exhausted British finances, and when the USA entered the war it took over the role of financier, lending around USD10 billion by the end of the war. These and other loans between the Allies and from neutral countries came due after the war. The winning countries in the war, predominantly Britain and France, tried to shift this burden to the defeated countries, primarily Germany, which was required not only to pay reparations for damages to civilians but also the Allied governments' war expenses (indemnities). The negotiations conducted at the Paris Peace Conference did not succeed in cancelling the debt owed to the United States or Germany's war reparations. Instead, Germany began to pay off reparations in 1919; not only in cash but also in goods (coal, chemicals), and in 1921 it was issued a bill of about USD 33 billion, more than double the German national income.[26]

The victorious countries used the reparations that they received from Germany for debt repayment to the United States, but the repayment capacity of Germany was limited because it depended on Germany's positive trade deficit, which it secured through the influx of gold or foreign currency in which the reparations were paid. Due to the weakness of its economy and other restrictions imposed after the war, Germany was unable to pay the annual amount of reparations. In late 1922 this caused a dramatic drop in the value of the German mark and an increase in the inflation rate, and repayments were suspended. In order to ensure the payment of reparations, in January 1923 France and Belgium occupied coal mines and railroads in the Ruhr, provoking passive resistance from the German people. The German government started printing money to pay the Ruhr workers and other employees. This lead to hyperinflation and the value of the German mark crashed (Table5). Similar trends in local currencies occurred in the country successors to the Habsburg Monarchy as well as in Bulgaria, Greece, and Poland.

[26] Cameron (2003), p. 345.

Table 4: Exchange value: the German mark – US dollar[27]

Date	German mark	USA dollar
June 1914	4.2 German mark	1 USA dollar
November 1918	14 German mark	1 USA dollar
July 1922	493 German mark	1 USA dollar
January 1923	17,792 German mark	1 USA dollar
November 15, 1923	4.2 trillion German mark	1 USA dollar

The French occupation of the Ruhr destabilized not only the German economy but also the French currency, which lost significant value. The solution came from the United States, which proposed reducing the annual amount of reparations to the amount that Germany could afford, the reorganization of the German central bank, the Reichsbank, and giving a loan to Germany. This allowed Germany to resume paying reparations and to return to the gold standard, which provided much-needed credibility. However, the hyperinflation would have drastic consequences for economic, social, and political trends in Germany in the years to come. The middle class was impoverished and those who lived on fixed income were pauperized. There was a significant redistribution of income and ordinary Germans lost their savings overnight, with drastically lower standards of living in the following years. This led to the rise of extremist political movements in Germany, so that Communists and Nationalists achieved significant success in the German Reichstag elections in 1924. In the following years Germany experienced some recovery, but its economy became dependant on the inflow of capital from abroad, especially from the United States. Therefore the collapse of the American economic boom that came with the onset of the Great Depression in 1929 meant the end of the German upswing and another dramatic economic decline, which ended with the Nazis getting into power and the introduction of the dictatorship that culminated in the Second World War.

In contrast to the gold standard, which had operated almost without any problems for more than thirty years before the war, the interwar standard was significantly shaken in 1931, when it was suspended by many countries, only to be discarded entirely in 1936. This was due to different factors, from the problems of international trade and monetary harmonization as a result of the devastating effects of the war and the slow return to 'normal', to technical problems in the implementation of the gold standard. This was topped by the lack of a leader (hegemony) in the management system, which previously had been the Bank of England. Although the Bank of England tried to maintain this position, it failed due to strong recessionary pressures and loss of Britain's position as the financial world leader. The new world leader, the United States, on which European economies were increasingly dependent for their recovery, did not have much experience of

[27] Cameron (2003), pp.345-346.

managing the monetary system, their central bank, the Federal Reserve, having only been founded in 1914. Attempts by the Governor of the Bank of England to organize an 'internationale' of central banks that would, together with the market and governments, be the third most important 'independent power' in the market system, failed due to nationalism and alack of international economic coordination. The fate of the gold standard was inextricably linked to the Great Depression (1929-33), the state of the American economy, and the American financial system, which almost completely collapsed during the Depression, shaking the European economies and their financial and banking systems, which were dependent on American capital.

It soon became obvious that the premise on which the gold standard rested was further deepening recessionary trends in the United States as well as globally, and that the monetary contraction in the United States in 1928that ended the unrealistic economic expansion was contributing to the onset of the crisis. Thus, the behaviour of the American economy in the interwar period is often deemed 'schizophrenic' because it featured two completely different phases, an unprecedented rise followed by an unprecedented crash, caused by an economic policy that was a mixture of protectionism and neo-mercantilist measures on the one hand and laissez-faire monetary and fiscal policy on the other. The responsibility for such a sequence of events lay in underdeveloped economic theory that failed to understand the behaviour of the economic system as a whole. Some economists, the most prominent of whom was John Maynard Keynes, did consider the whole economic system, and this was called macroeconomics.

However, laissez-faire economics was not easily dismissed even though the Great Depression was another painful indication that this concept was neither universal nor omnipotent. It would be abandoned in the subsequent years, but a very bad economic situation, primarily manifested as extremely high unemployment, led to political turmoil and dictatorial and anti-democratic regimes. They too based their economic policies on state intervention, but with retrograde political ideas that would cost humanity dearly in the coming years. The economic problems of the interwar period were the key cause of World War II, which is often regarded as a continuation of WWI so that the period from 1914 to 1944 is referred to as the 'Thirty Years War'. Only the Second World War succeeded in providing some viable economic solutions through the establishment of an international monetary system at Bretton Woods in 1944, which successfully operated until the 1970s. This agreement between the victorious powers was based on a more realistic approach to the world economic and political order and took into account the bad experiences of the interwar period.

5. THE RESPONSE OF ECONOMIC THEORY – THE ORIGINS OF KEYNESIAN MACROECONOMICS

Initially, economic theory had failed to understand the complex circumstances and socio-political trends after the First World War, but this quickly changed. One of the most important economists of the time who to a great extent facilitated these changes was John Maynard Keynes. Already in 1924 he had announced the end of the laissez-faire concept in a lecture at Oxford University: "We do not dance even yet to a new tune. … But change is in the air" (Burgin 2012, p.1).

According to Keynes, two ideological factors were preventing change in economic policy and theory. The first was the determination to prevent the penetration of Marxist theory and ideology, which was of particular importance after the victory of the Bolsheviks during the October Revolution. Keynes himself strongly opposed Marxist doctrine, deeming it "illogical and dull", but at the same time extremely influential[28]. The second was the growing protectionism, whose obvious negative effects increased support for the laissez-faire system.

Keynes advocated "wisely managed" capitalism, in which intervention would minimize the failures of the market without affecting the basic principles of the market economy. The end of laissez-faire, according to Keynes, was not the end of the marketplace. Government intervention in capitalism should help capitalism overcome the obvious problems that threatened its survival.

The changes that Keynes 'felt in the air' required a new economic theory as much as a new economic policy. Some of Keynes's new economic ideas were directly linked to the conditions of the peace set out in the Versailles Treaty in 1918. In his book *The Economic Consequences of the Peace*, written immediately after the end of World War I, Keynes detailed the negative consequences for the future of the unrealistically defined economic and political order in Europe and the degrading conditions imposed on Germany. The unresolved economic and political relations between leading European economies and the lack of an international monetary and economic order later proved to have far-reaching consequences. In 1935 Keynes wrote in a letter to George Bernard Shaw, "…you have to know that I believe myself to be writing a book on economic theory which will largely revolutionize - not, I suppose, at once but in the course of the next ten years - the way the world thinks about economic problems". Towards the end of the Second World War Keynes was instrumental in facilitating the 1944 Bretton Woods agreement, which, three decades after the beginning of the First World War, finally laid the foundations of a new economic order, which would ensure prosperity in the coming decades.

Keynes's revolutionary ideas, which he developed in his essays and books, questioned the essence of the functioning of the market economic system and its

[28] Burgin (2012), p.2.

self-corrective character. His theory challenged the macroeconomic performance of Say's law of markets, which indicated a possible situation of insufficient aggregate demand. Keynes's assumption of effective demand, which equals aggregate supply and demand, is a key part of his theory. The explanation of the concept of effective demand required a new theory of interest, money, and employment, which Keynes presented in his most important work, *The General Theory of Employment, Interest and Money*. Keynes believed this theory to be 'general' as opposed to classic economic theory, which was only applicable in specific situations.

Poor economic development in Britain, and from the Great Depression in the 1930s in the United States and the rest of the world as well, contributed to the victory of Keynes's theory over 'classic'theory, as he named the economic theory of the previous period. In this sense, Keynes's theory was contextual, but these economic events were themselves often the result of attempts of economic policy to adhere to the assumptions of the laissez-faire concept, when they were obviously wrong. One example was the return to the gold standard, especially in Britain, which adopted an unrealistically high parity, leading to dramatic economic consequences, which Keynes warned against in his timely 1925 essay, *The Economic Consequences of Mr. Churchill*.

Keynesian criticism of pursuing a rigid monetary policy to ensure the macroeconomic stability necessary for economic growth was based on his view of the non-neutrality of money, which can affect the real economy, economic activity in particular, through investment and consumption. This is connected to yet another important change in relation to the then-prevailing neoclassical theory, Keynes's re-affirmation of the social relationships reflected in macroeconomic performance. Keynes was fully aware of the importance of collective social players in the functioning of the economic system. These ideas had been present in classical political economy but were later abandoned by neoclassicism, which developed the theory of objective pricing off actors of production. Unlike a neoclassical individual – a consumer or a producer who is not a member of any class or nation - Keynes's social players influence economic trends. The key factors are distribution and redistribution, which may ultimately have a decisive influence on economic prosperity. Another important concept of Keynes was the marginal propensity to consume, which influences the amount of private consumption and hence effective demand, and is determined by the amount of income that individuals receive and thus differs between the rich and the poor.

Keynes radically changed the classic approach to the analysis of the economic system by emphasising the uncertainty endemic in capitalism. His concept of fundamental uncertainty provided an alternative view of how an economic system functions, in which it is not possible to be certain of the consequences of economic decisions in the way classical theory believed it was. The uncertainty that Keynes introduced was important in differentiating his theory from classical ideas:

"I accuse the classical economic theory of being itself one of those pretty, polite techniques which tries to deal with the present by abstracting from the fact that we know very little about the future."[29] Keynes tried to provide an "alternative to 'classical' ways of thinking about the economy."[30]

Because of the massive unemployment in Britain in the interwar period and in the United States during the Great Depression, the central economic problem that Keynes analysed in order to provide appropriate economic policy recommendations was unemployment. Classical theory was based on an analysis of partial equilibrium and said that the unemployment rate depended on the marginal productivity of labour, which is also the demand for labour, while equilibrium is established by adjusting both the number of employees and their real wages. Keynes considered unemployment from a completely new, macroeconomic point of view: unemployment is not solely the result of imbalance but also occurs in a state of equilibrium that is established at a lower income than full employment, since the scope of employment is determined by the amount of aggregate demand, i.e., income. Unemployment depends on changes in the amount of aggregate values such as aggregate demand, which, in turn, depends on the marginal propensity to consume, marginal efficiency of capital, and psychological factors that decisively determine the behaviour of investors. Therefore, the states of recession and expansion are inherent to the capitalist system and result from investor errors in the perception of returns, which are due to psychological factors created by the conditions of optimism and pessimism. The Keynesian concept of uncertainty is crucial to this. The capitalist economic system, left on its own, will tend towards a state of suboptimal equilibrium with unemployment, or, to be exact, involuntary unemployment. In order to avoid this, the state must intervene to bring aggregate demand to the level at which there is full employment. This requires fiscal policy measures, because monetary policy is not efficient enough to combat recession.

Keynes's most important work, The General Theory of Employment, Interest and Money, testifies to the correctness of the view that "the single most important aspect of Keynes the economist is his orientation toward policy"[31]. It is primarily a theoretical book, intended for academic economists, and then for economic policy makers and the general public. His theory is a combination of realistic and analytical approaches. The assumptions that Keynes's theory is based on are taken directly from the economic environment in which he worked. Thus, his theory, regardless of how abstract it may be, never overlooked the implications it would have for economic policy. Keynesian economic theory did significantly influence economic policy, although the impact was more significant after World War II, and less during the interwar period when Keynes was active. Nevertheless, during his

[29] Keynes (1937), p.218.
[30] Backhouse (1995), p.124
[31] Landreth and Collander (1994), p.461

life Keynes secured a significant following, which would later develop his ideas in different Keynesian schools that dominated economics until the 1970s when the laissez-faire concept had a big revival, both in economic theory and in policy.

6. CONCLUSION

The laissez-faire concept was important for global economic development during the centuries before the First World War. Developed in British Classical Political Economy, the concept was regarded as crucial for economic policymaking. Despite the apparent success of laissez-faire economic policy, the rapid economic development that it encouraged led to an imbalance in economic and political power between countries, which were one of the causes of Word War I. This was especially the case in the economically backward countries of the European 'periphery', including the countries of South and Eastern Europe. On the eve of the war British economic growth had slowed down but global economic growth was significant, due to the growth of the modern sector. This increased political tensions between the three most industrially advanced European economies, Britain, Germany, and France. At the same time the rise of the United States' economy meant the end of 18th century liberalism and the 'European' 19th century, and the beginning of the 20th century when non-European powers would be of equal, if not greater, importance.

After the First World War the economic system, based on the laissez-faire concept of economic policymaking, was in deep trouble, indicating that the golden age of the liberal concept was over and that a new economic policy was needed that emphasised fiscal policy as the best method for improving employment and effecting economic activity. After the war European economies abandoned free trade and turned to government intervention, a regulated market system, economic nationalism, and protectionism, with negative effects on global trade and production, all of which resulted in attempts to maintain the laissez-faire system. However, in the interwar period the key elements of the laissez-faire system were gradually questioned and abandoned. These changes were neither easy nor simple, demanding as they did changes in both economic theory and economic policy. The unrealistic assumptions of neoclassical theory could not resolve the emerging economic problems of rising unemployment, huge budget deficits, and inflation. Laissez-faire economics' solution to monetary and public finance problems was the implementation of the gold standard, so that the fate of the gold standard reflected the fate of laissez-faire policy. A new economic paradigm was needed. The British economist, John Maynard Keynes, provided a new macroeconomic approach to economic theory

These developments in economic theory were also induced by the economic developments that culminated in the Great Depression (1929-33), which confirmed that the laissez-faire system was no longer efficient even in the economy where it had produced its best results. However, the methods and elements of government intervention were, at first, a great unknown. The end of World War II marked the final, although temporary, end of the laissez-faire concept in economic policymaking and the transition to government intervention or so-called Keynesian economics.

REFERENCES

Backhouse, R. E. (1995), *Interpreting Macroeconomics*, Routledge, London

Berend, I. T. (2013), *An Economic History of Twentieth Century Europe*, 6th ed, Cambridge University Press, Cambridge.

Bernanke, B. (2004), *Essays on the Great Depression*, Princeton University Press, Princeton, New Jersey

Burgin, A. (2012), *The Great Persuasion – Reinventing FreeMarkets since the Depression*, Harvard University Press, Cambridge, Mass.

Cameron, R. and Neal, L. (2003), *A Concise Economic History of the World*, 4th ed, Oxford University Press, Oxford.

Carreras, A. (2006), "The twentieth century – from break with the past to prosperity (I): growth and transformation of the economy", in *An Economic History of Europe*, Di Vittorio, A. (ed.), Routledge, London

Carreras, A. (2006), "The twentieth century – from break with the past to prosperity (II): the great stages", in *An Economic History of Europe*, Di Vittorio, A. (ed.), Routledge, London

Chavance, B. (2009), *Institutional Economics*, Routledge Frontiers of Political Economy, Abingdon

Hughes, J. and Cain, L. P. (2007), *American Economic History*, Pearson Addison Wesley, Boston

Jakšić, M. and Praščević, A. (2007), *Istorija ekonomije*, Ekonomski fakultet Univerziteta u Beogradu, Beograd

Keynes, J. M. (1936), *The General Theory of Employment, Interest and Money*, London: MacMillan Cambridge University Press

Landreth, H. and Colander, D. C. (1994), *History of Economic Thought*, 3rd ed., Houghton Mifflin Company, Boston

List, F. (2005), *National System of Political Economy*, Cosimo Inc., New York

Robbins, L. (2000), *A History of Economic Thought – The LSE Lectures*, Medema, S. G., Samuels, W. J. (ed.), Princeton University Press, Princeton, New Jersey

Roncaglia, A. (2006), *The Wealth of Ideas – A History of Economic Thought*, CUP, Cambridge

Schumpeter, J. A. (1975, [1954]), *Povijest ekonomske analize*, Informator, Zagreb

Wolf, H. C. and Yousef, T. M. (2007), "Breaking the Fetters: Why Did Countries Exit the Interwar Gold Standard?"in*The New Comparative Economic History*, Hatton, T., O`Rourke, K., H., Taylor, A., M. (eds), MIT Press, Cambridge, Mass.

http://www.maynardkeynes.org/john-maynard-keynes-treatise-general-theory.html

Chapter 7

The First World War and Processuality in the World System

Miomir Jakšić*
E-mail: mjaksic@ekof.bg.ac.rs

Abstract: Instead of the idea of the inevitability of progress, the 'world system perspective' highlights the significance of uncertainty and the domination of stochastic processes. Space and time gain new significance: space is indivisible, time is not mechanically repetitive. In the midst of historical science, 'longue duree' should replace 'point events'.

The world system perspective is holistic (based upon large units of analysis), cyclical (microstructures are objects of cycles), and trendual (changes are analysed only within the 'longue duree'). Historical science should focus on the history of events, conjectures, and structures.

Traditional history is a history of events: instead of events, scientific research should pinpoint two phenomena: (1) economic and political structures that 'last'; and (2) cyclical and conjectural changes in the functioning of those structures. The author uses the dissolution of monetary regimes after WWI throughout Europe as historical evidence of the superiority of this approach.

Keywords: world system theory, globalisation, hyperinflation, market fundamentalism.

1. THE PERSUADERS

The crisis of 2008 is reminiscent of a scene in the novel Murder on the Orient Express: it seems that all the suspects are murderers: the circle is complete - from demand to supply, from monetary to real factors, from economy to politics (Vane and Snowdon, 2002).

The crisis of 1929 came as an unexpected shock to the theorists and practitioners of laissez-faire economics, who were unprepared and reacted *ad hoc*, creating a sort of hocus-pocus or DIY economics, reluctantly introducing the country into the economic model and policy.

The fundamental differences that separate the Great Depression of 1929 from the crisis of 2008 are more important than the similarities in terms of key macroeconomic indicators: in September 2008 countries' response times were much

* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179065) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

shorter, which was the result of the positive effects of Keynesian intervention and regulation: instead of resorting to a monetarist policy of restrictions, the hardest-hit sectors - first that of banking and finance, and then the real sector - were offered sufficient amounts of liquid assets. There were no ideological and theoretical biases, and after 30 years of unchallenged monetarist rule it seems as if Nixon's assertion "We are all Keynesians now" has become topical once again.

Three ideologies - conservatism, liberalism, and Marxism - characterized 19th century science (Wallerstein, 1992). Conservatism prioritized the preservation of the existing structures, which in turn functioned as a brake on the aspirations of reformers and revolutionaries. Tradition was a priority, and on its foundation rested family, community, the church, and the monarchy. The second ideology, liberalism, was a natural ideology of normal changes. Its guiding idea was deliberately initiated and implemented reforms that would liberate human will and actions from the clutches of the state. Marxism added only two new premises: first, progress is not achieved continuously but discontinuously through revolutions; second, in their rise towards a perfectly good society, people have reached the penultimate stage of capitalism, and communism is just ahead. Their common basis was the 19th century paradigm of the possibility of disciplinary knowledge of the world from the perspective of philosophy, politics, and economics, and the inevitability of progress that society derives from transforming a not-so-good condition into a better one.

The dimensions of the system are crucial: small systems are dominated by boundary conditions in the environment, and only when the system is large enough does it gain autonomy. From a historical perspective, the experience of small peripheral societies like the former Yugoslavia confirms this viewpoint, rather than the universal progressive role of globalisation.

Units (bodies) are suppressed for the sake of interactions, since no single unit is 'alone in the world'; time is not mechanically repeatable (reversible), a "plurality of times", inextricably and closely intertwined, is established. Newtonian social science, which considered states as relatively autonomous structures, is obsolete, since the sovereignty of states in the interstate system is restricted. It is not even certain that states are the real bearers of sovereignty and power in the interstate system, given the emergence of transnational corporations and international economic and political integration. Capitalism is not a collection of established and unchangeable relations, structures, and institutions, but, on the contrary, a continually changing historical system that has the potential for internal change but will also reach the limits of its existence. Structures - family, household, class, nation, and especially the state - used to be considered as eternal institutions that are transmitted from one historical system to another with minor changes.

One of the most important consequences - we could say the most devastating consequence - of market fundamentalism, which is a kind of religious fundamentalism, is the illusion that the economic establishment of free market competition automatically leads to political democracy. In post-socialist transition countries this did not happen, which resulted in a loss of confidence in the possibility of establishing a democratic system. The democratic system, as a set of institutions, cannot be equated with the marketing terms of its durability: the disappointing results of the market economy, the numerous and persistent market failures that culminated in the Great Recession of 2008, do not obscure the perspective of a democratic system when the underlying causes and factors lie elsewhere. "The greatest enemy of France is the world of finance, someone without a name, without a face, someone who has never been elected, nor shall be elected in elections, and yet rules over everyone. This is not a quote from the manifesto of a group of protesters against Wall Street … Although it irresistibly resembles the conclusions of global street choirs, the author of this article is Francois Hollande, the candidate with the best chance to be elected as the President of France this spring" *(Šuvaković*, 2012).

Even before the mass Occupy Wall Street protests, students of economics at the London School of Economics and the Sorbonne revolted against 'Only One Theory', that of 'market fundamentalism', which has limitless faith in the theoretical and practical powers of the market and which, as an economic institution, also determines the political system (Lavoie, 2009). Those that have markets have democracy. Many market fundamentalist economists have become the "persuaders" who persuade public opinion, not "problem solvers" (Backhause, 1997).

The economist T. Lawson, paraphrasing the title of the famous London theatre show "No Sex Please, We're British", translated it into the economic sphere, "No Reality Please, We're Economists" (Lawson, 1997).

For many, the collapse of the Eastern Bloc after 1989 confirmed the absurdity of all utopian ideas of an ideal society and economy as a desire to attain 'nowhereness'. It is embodied in the thesis of "The End of History" because, allegedly, market individualism (fundamentalism), which finally reached 'nowhereness', is an eternal ideal, which, like nature, is eternal, permanent, and unchanging. The famous neo-institutionalist G. Hodgson shows that there is no final end and that a utopian paradigm – centrally planned socialism - is merely replaced by another – market individualism, based on identical grounds of ideological exclusion, naturalisation, unchangeability and exclusivity (Hodgson, 2000). Nobel Laureate J. Stiglitz later called it "market fundamentalism".

G. Hodgson wrote: "The learning economy is not the end of history": learning means maturing, changing, interaction between individuals and society, pushing the limits of the possible, survival within the limits of tolerance: this is not how the old central-planning paradigm and today's market individualism interpret the development of the individual and society: for them, society is a known exclusive and unique model, and there is only one future. In his theory of the global system, Wallerstein showed that global power relations cannot be explained by the mechanistic model of market fundamentalism, but must be based on the dissipative structures discovered by I. Prigogine.

In line with global trends in science and its teaching about survival under conditions of stochastic processes, in an environment of self-organization and chaos and permanent evolution and revolution, G. Hodgson says that the "End of History" embodied in an achieved and eternal order does not exist, since both institutions and individuals are changing during the process of learning and cognition, in terms of innovation and the rapid diffusion of knowledge. Nor is there an 'End of Economy' based on market fundamentalism, and if there is something positive to be taken from the economic crisis of 2008, it is shaken confidence in the omnipotence of free-market competition.

Learning is not a mere accumulation of information, but also a pushing of the boundaries of the abilities and skills of individuals and society, rejecting outdated visions and ideas and adopting new ones, in terms not only of one but of different futures, as demonstrated by I. Prigogine. Instead of traditional socialism or market individualism, Hodgson speaks of "market cognitivism" and "a learning economy". (Hodgson, 2000).

The challenge for the 21st century is not the development of a fixed and final 'utopia', but rather the development of a 'eutopia': instead of a u-topia (a place that does not exist), the goal is to create a eutopia (a place that evolves, a place that develops). It is a system that encourages learning and human potential, systematically incorporates knowledge, and adapts to changing circumstances. Its characteristics are that:

- The rule of uncertainty and incomplete knowledge prevents completely rational social and economic policies;
- Policy is subject to constant experimentation and numerous variations of routine, knowledge, and institutions;
- Inherent variety increases the ability of the system to adapt to unforeseen circumstances; variety is crucial for learning and the adaptability of both the system and the individual;
- The inability to establish an individual or an institution's permanent and perpetual 'omnipotence' indicates that there is no final estimation of what we want and what we aspire to. Learning and adaptation require a participatory and democratic dialogue that includes scientific and normative issues of the future (Collander, 2000).

If an economy is complex, then individuals cannot rationally master all its parts, so the model of global rationality is inconsistent with the model'scomplex structure. That is why institutions appear that change their behaviour. Today, this is the situation in the theory of regulation and in the activities of powerful regulatory bodies in key network industries such as energy, transport, and broadcasting.

Market institutions are not a limiting but a stimulating factor; the market is a process, permanently restoring and disturbing balance (Hodgson, 2000).

The link between market and institution is to be understood through three important assumptions.

1. There is no Pareto-dominant superior policy that guarantees that all individuals will be better off with this policy than with another policy, as different policies have different effects on different social groups (workers in relation to financial markets, domestic relative to foreign creditors, debtors relative to creditors).
2. Different groups are forced to bear different risks, especially those linked to gains and losses.
3. Due to the different effects of macroeconomic policies, democratic society cannot leave policymaking to technocrats (experts), but policy must be focused on its accountability to parliament (Stiglitz and Serra, 2008).

The global crisis is like a scene from a cartoon: the hero runs over an abyss and does not fall until he looks down. It is an 'enchanted world', as described by A. Lipietz thirty years ago (Lipietz, 1985).

Transition in socialist countries was based on the neglect of the heritage of the old and the new institutionalism and exaggeration of liberal neoclassical economics, based on the false belief that there is guaranteed interdependence between democracy (politics) and free-market competition (economy).

2. DOMINANT INTERPRETATIONS OF GLOBALISATION

There is a global tension in capitalism between the universalism of a single economy (global world) and separate cultural and political entities (states). Universalism rested on the commodification of everything, primarily labour, which broke the medieval constraints and allowed the free flow of labour as a factor of production. This economic universalism, as a determination in the last instance, conflicts with the particularism of ethnicity, race, and nation. The central question is: why did the formation of capitalism concentrate on the nation, individualized in the form of a strong state apparatus (Balibar and Wallerstein, 1991). The answers should be sought in, first, the hegemony of the dominant class as based on the ability to organize the work processes, and second, reliance on universalism as the dominant ideology. I. Wallerstein demonstrated that the rise of the curve of universalism is not accompanied by a decline in the curve of racial and ethnic differences; on the contrary, they also grow, and thus show the relative autonomy of non-economic agents - political and ideological in relation to the economic agent that is determinant, but only in the "last instance".

The apparently contradictory simultaneous ascent of economic universalism and political particularism can be explained by three facts.

First, this kind of particularism enables ghettoisation, creating special enclaves within which it is possible to bring down wages and worsen working conditions and effect super-exploitation.

Second, it is possible to constantly recreate particularistic entities such as the extended family and the commune as units of life and reproduction. This means that monetary income is only one part of the total income of a household as the unit of inflows and outflows of income.

Third, racism as anti-universalism provides for the achievement of just the goal capitalism is most interested in: the exploitation of labour, either based on universalistic commoditisation or particularistic subsistence.

The global system is based on capitalism and its key elements are as follows: first, it is the only production method in which maximization of surplus is inherently rewarded; second, the surplus is not maximized only at a given moment but is also reinvested, and those who do it, the holders of accumulation, are constantly further rewarded; third, the pursuit of profit takes place in an environment in which companies are legally protected; and fourth, all structures and institutions are located within the boundaries of the market, which can be described as a mechanism for rewarding investment and limiting spending.

There is no ideal type of capitalism, there is only process, as capitalism too is a historic system with a beginning and end. The axes of this system are the spatial and temporal universalisation of the market - the commoditisation of everything, the embourgeoisement of capital, and the proletarianisation of labour. In a nutshell, success is a prerequisite for embourgeoisement.

The key contradiction of capitalism is that between short-term profitability and potential long-term fiascos and failures. One of the obstacles to these processes is the constant and ever more comprehensive spatial commoditisation of labour, which pulls new consumers into the commodity chain. Countries play an important role in this situation since they 'limit the market' by limiting access of others to the domestic market or to the foreign markets they control. Thus, relying on the unique principles of the global capitalist economy, there is a constant interstate conflict of players that limits the power of other players.

Within the global capitalist system there is a constant collision between two tendencies, the universalistic, relying on a single economic basis, and the particularistic, based on the special quality of political entities (states). This conflict is far from finished, and its basis is the strong correspondence between a strong state and economic power, which was, is, and remains the secret of the success of highly developed countries.

Breaking the *ancien regime* of privilege, monopoly, seniority rights, leisure, superstition, particularism, and religious obedience, and the rise of Renaissance universalism, united the world economically, creating the global market; but did not, nor will in the foreseeable future, remove the key actors of this global historical process - states. Goods 'ascend and descend' along commodity chains, and the same is true for states. These processes are long-lasting, they are the *longue duree* and there is no final outcome and establishment of equilibrium of power.

There are three dominant interpretations of globalisation.

1. World-system theory. From the mid-16th century the world has been integrated into a network of communication, trade, and production based on market relations and commodity chains: the nation-state, and, according to Wallerstein, reciprocal mini-systems become parts of the world capitalist system and are in the position of peripheral countries, semi-peripheral countries, or core countries. E. Hobsbawm noted the following characteristics of the United World: in the period 1720–1780 global trade doubled in value, in the period 1780-1840 it tripled; in 1870 the per capita value of the trade of Britain, France, Germany, Austria, and Scandinavia was 45 times higher than in 1830; in the period 1840-1875 the value of trade between the most developed countries and developing countries increased sixfold (Hobsbawm, 1975).

2. Neoliberal institutionalism. Instead of states that are part of a world system, the focus is on a worldwide network of interests - power and security - within which, as in game theory, the outcome depends on the strategies chosen by other partners. According to Robert Keohane and Joseph Nye, it is a transnational system of complex interdependence (Keohane and Nye, 2001) In contrast to political realism, which sees the nation state as absolutely sovereign, these authors define a complex interdependence within which absolute sovereignty becomes relative. The realists start from three assumptions:

a. states as harmonious units are the dominant players in world politics;
b. force is an effective political means that may be utilised;
c. in world politics there is a hierarchy of issues and problems, and military security occupies the first place.

The following is the ideal type of world politics, with which these authors' model is juxtaposed.

a. states are not the only players in world politics;
b. there is no hierarchy of problems, but a complex network of issues;
c. force is not an efficient means of politics.

The complex interdependence of policy fully meets the network models and shallow organizations of economy because:

1. Multiple channels link states and societies (interstate, transgovernmental, and transnational): 'interstate' corresponds to the realistic model, 'transgovernmen-

tal' channels occur if the state is no longer seen as a single player, and 'transnational' channels occur if the states are no longer seen as the only players.
2. There is no hierarchy of problems and issues topped by military security, but the development of a complex matrix of global issues (energy, resources, environment, etc.).
3. Military force in the changed circumstances of complex interdependence is no longer the only and effective means of conflict resolution.

Table. 1. Political processes in the circumstances of realism and complex interdependence (Keohane and Nye, 2001).

	Realism	Complex interdependence
Goals of players	Military security as the predominant goal	Goals of states change depending on the problems. Transgovernmental policy hinders the definition of goals. Transnational players set their own goals
State policy instruments	Military force is the most efficient, although other economic instruments may be used	Sources of power relevant for individual problems are the most important. Manipulation with interdependence, international organisations, and transnational players is the most important instrument.
A group of problems	Possible change of equilibrium of powers and security challenges determine the problem that High Politics should deal with and this influences everything else	The group of problems is affected by changes in the equilibrium of powers in individual domains, the state of the international regime, changes in the importance of transnational players, and interconnection of individual issues; and their politicisation are a pre-condition for growing interdependence
Approach to problems	Links between subjects diminish the differences in approach and strengthen the international hierarchy	It is harder to establish connections between strong states, because force becomes the most efficient. Connections between weaker states via international organisations will weaken, not strengthen the hierarchy
The role of international organisations	Their role is negligible and limited by military force and the power of states	Organisations will define problems, encourage the emergence of coalitions, and be the scene for weaker states to play in. The ability to choose an organisational forum and mobilise support will be an important political resource

3. International community theory. States are important, but are situated in the environment of the world community, so their sovereignty is constricted by the activities of international institutions and movements. The theoreticians are A. J. Meyer and S. Strange.

3. ECONOMIC CONSEQUENCES OF THE FIRST WORLD WAR: HYPERINFLATION AND THE DESTRUCTION OF EUROPEAN MONETARY REGIMES

P. Bernholz placed economic and political relations between money and inflation from Roman to modern times in three universally valid postulates:

1. Establish a metal - gold or silver - standard, which exhibits a much lower tendency to inflation.
2. A paper standard should be attached to a central bank that is independent of political authorities.
3. A paper standard should be based on a fixed exchange rate, or currency board. If at least one of these conditions is ensured, the monetary regime manifests a lower tendency towards inflation (Bernholz, 2003).

There are several features common to all cases of hyperinflation:

1. A fall in the real stock of money to a negligible level due to an enormous rise in prices.
2. A fall in the exchange rate of the domestic currency.
3. A systematic increase in the budgetary deficit, which is the first driver of the inflation-hyperinflationary spiral.
4. In the life cycle of currency substitution, as long as the money illusion works, Gresham's law works, where inflationary bad currency drives out good, which everybody keeps for themselves; and with the termination of monetary illusion Thier's law starts to apply.

3. MONETARY REGIME

Monetary regime is "a set of rules of conduct of institutions and organizations that ultimately determine the supply of money. If we consider laws and regulations with the formal rules, we are talking about the monetary constitution" (Bernholz). The following are possible monetary regimes:

1. Metallic standard. Gold, silver, and copper standards mean that the face value of the coin is equal to the commodity value of the metal contained in the respective coin. If several countries are on the gold standard, then the rates of their currencies are fixed against gold, and oscillations are possible within the narrow limits of certain transportation and insurance costs.

2. Weakened metallic standard. After the First World War several countries returned to the gold standard without allowing the circulation of gold coins, and after World War II the Bretton-Woods system allowed only central banks to convert dollars into gold at the established exchange rate, which lasted until 1971.

3. Paper standard. The central bank has a monopoly on issuing bank notes, and deposit holders are entitled to convert the amount of deposits into banknotes at a fixed one-to-one parity. This standard is discretionary in character because monetary authorities determine the offer of base money. Two important features of this standard are:

a) the degree of autonomy/dependency of the central bank, and b) whether the exchange rate is fixed or flexible.

The German economist A. Wagner, wrote in 1868: *"Experience with paper money until today proves at least that it is possible to give value to a paper money, which cannot be exchanged any time at a fixed parity at will into another money. The obstacle for maintaining an equal purchasing power is the impossibility to fulfil the requirements for the strength of this belief. One would have to introduce the most reliable guarantees to prevent that paper money would ever be used for financial purposes to create artificial purchasing power. These guarantees imply absolute impossibility to increase the money arbitrarily. Men would first have to be capable of unlimited self-discipline to resist any temptation to increase money arbitrarily. Secondly, the right to issue money might perhaps be provided by one or the other constitutional form. But this certainly does not amount to a big difference."* (quoted in Bernholz, 2003, p.7)

The change from non-inflationary to inflationary long–term development can be explained by a change in the monetary regime between 1914 and 1930. This hypothesis is supported by two arguments:

1. All hyperinflations that occurred after 1914 occurred under discretionary paper money standards, and wars were not their primary cause;
2. All countries that switched from the gold to the paper standard during the 18th and 19th centuries have recorded higher inflation rates.

Hence Bernholz's most important conclusion: the long-term tendency of currencies towards inflation depends mainly on the monetary regime or constitution, as follows:

1. Metallic standards like the gold or silver standard show a smaller inflationary tendency than discretionary paper money standards;
2. Paper money standards with central banks independent of political authorities are less inflation-biased than those with dependent central banks;
3. Currencies based on discretionary paper standards and bound by a fixed exchange rate regime show a smaller tendency towards inflation relative to a paper standard with flexible exchange rate.

4. Monetary regimes whose necessary and sufficient conditions for monetary stability are metallic standard, an independent central bank, and fixed exchange rate show a far smaller tendency towards inflation. (Bernholz, 2003)

Table 2. Hyperinflation throughout history.

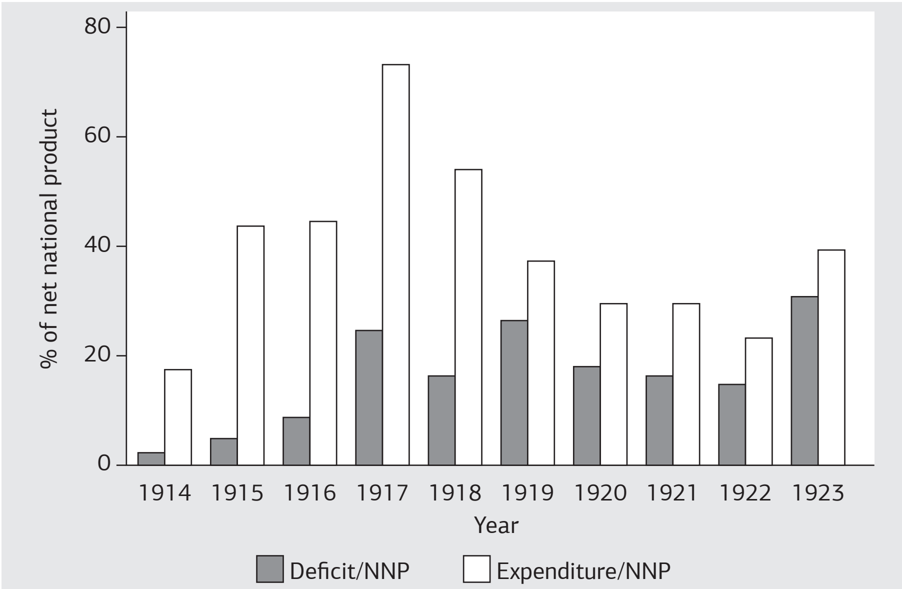
Country	Year	Highest inflation per month in %	Country	Year	Highest inflation per month in %
Argentina	1989/90	196.6	Hungary	1945/46	$1.295^{*}\ 10^{16}$
Armenia	1993/94	438.04	Kazakhstan	1994	57
Austria	1921/22	124.27	Kyrgyzstan	1992	157
Azerbaijan	1991/94	118.09	Nicaragua	1986/89	126.62
Belarus	1994	53.4	Peru	1988/90	114.12
Bolivia	1984/86	120.39	Poland	1921/24	187.54
Brazil	1989/93	84.32	Poland	1989/90	77.33
Bulgaria	1997	242.7	Serbia	1992/94	309.000.000
China	1947/49	4208.73	Soviet Union	1922/24	278.72
Congo	1991/94	225	Taiwan	1945/49	398.73
France	1789/96	143.26	Tajikistan	1995	78.1
Georgia	1993/94	196.72	Turkmenistan	1993/96	62.5
Germany	1920/23	29.525.71	Ukraine	1992/94	249
Greece	1942/45	11.288	Yugoslavia	1990	58.82
Hungary 1	1923/24	82.18			

Source: P. Bernholz, op. cit. p8.

4. HYPERINFLATION AND BUDGET DEFICITS

Victor Klemperer, Professor of Linguistics, left a testimony of the devastating consequences of German hyperinflation of 1922-1923: *"I have lost all feeling for numbers. Yesterday (8 October 1923) we paid for the cinema together with the fare for the tram 104 million marks ...today is again a last 'cheap day' for stamps of 2 million for a long distance letter, tomorrow will be 5 million. The dollar jumps daily by billions. On Saturday by 17 billion (20 October), and a loaf of bread costs now 1.5 billion. Yesterday (Thursday, 6 November 1923) we experienced our wildest day. On Monday morning I had received about 870 billion – who still counts figures below 100? Yesterday I gave order to sell three stocks and received 3.4 billion, which I had to spend at once. The mark exchange rate had been kept artificially at 420 billion, abroad the mark stood two to three times lower. At noon a new rate is quoted, to which all shops adapt immediately"* (quoted in Bernholz, 2003).

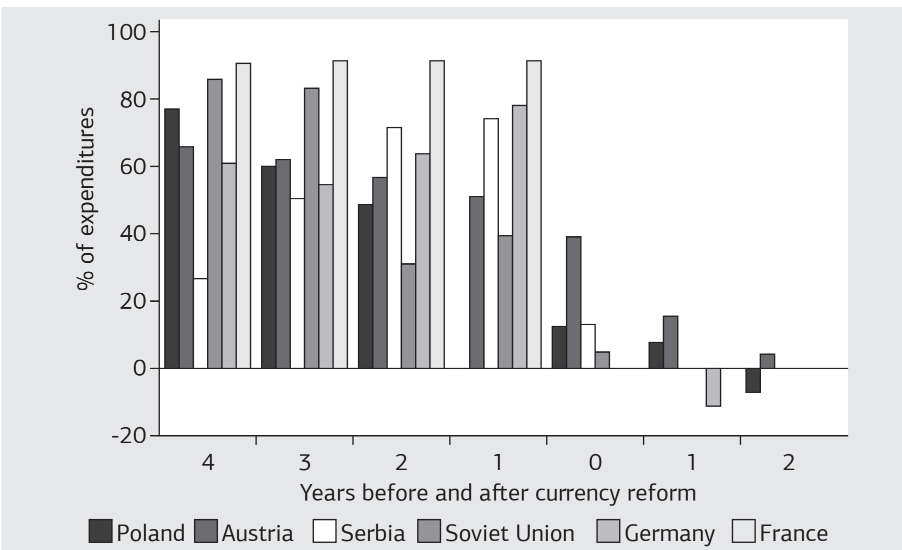
Fig. 1. Expenditures and deficit of the Reich, % net national product, at the time of German hyperinflation, 1914-1923.

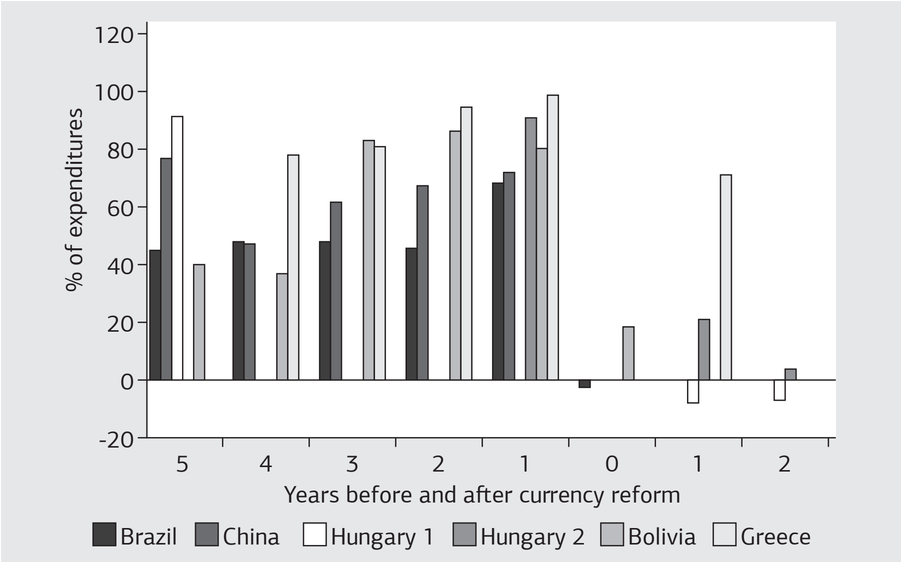


Source: P. Bernholz, 2003, p.72.

The analysis of 12 hyperinflations shows that all of them have been caused by huge budget deficits:

Fig. 2. Annual budget deficit in twelve hyperinflations.





Source: P. Bernholz, op. cit., p.70.

The experiences of these 12 hyperinflations show that deficits accounting for 40% or more of budget expenses, i.e., 30% or more of GDP cannot be maintained and naturally lead to high inflation and hyperinflation. This is also shown to be the case in the Table with 29 hyperinflations, where there were expenditures of 20% and more, except in the cases of Belarus, Turkmenistan, Poland, and Yugoslavia (there was even a surplus recorded, but Bernholz estimates that the data are not reliable). Hyperinflation was caused by issuing money to finance budget deficits that were caused by political decisions.

Writer Stefan Zweig describes the situation: *"At a first sign of the distrust on the part of the population the coins vanished in Austria, for a piece of copper or nickel had at least some substantive value compared to printed paper. It is true that the state drove the printing press to maximal performance, to create as much of this artificial money as possible, following the recipe of Mephistopheles. But it was unable to follow the speed of the inflation; as a consequence each city, each township and finally each village began to create for its own purpose 'emergency money', which was rejected in the next village, and later thrown away because it was recognised as having no value. From this time the Austrian peasants tried to get only industrial products and asked for real goods for their own produce. Goods for goods. A grotesque exchange began throughout the whole country. The people from the cities carried out to the peasants everything they could spare; Chinese vases and carpets, sabres and shotguns, photographic equipment and books, lamps and decorations"* (quoted in Bernholz, 2003).

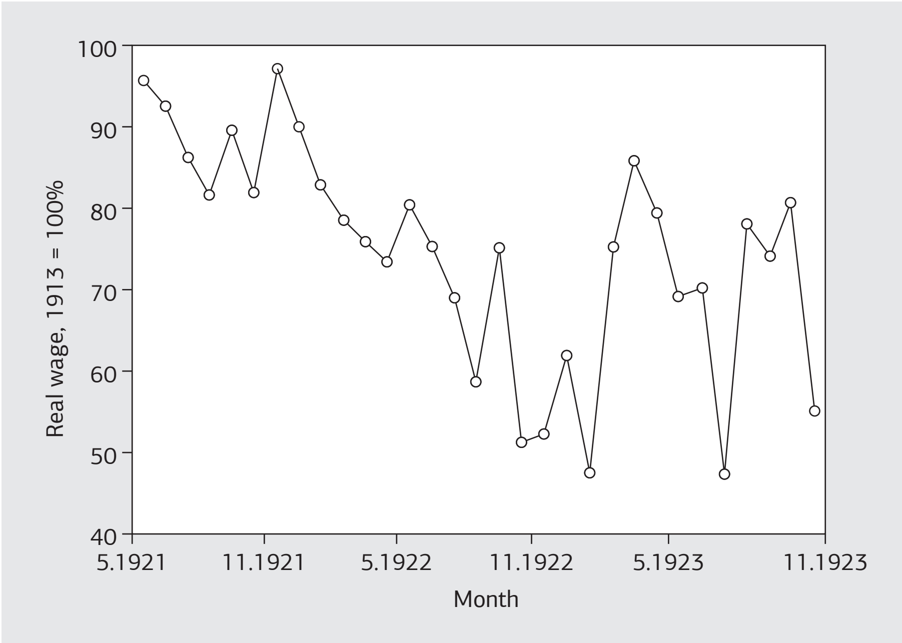
Initially, precious metals or foreign money are used as a measure of value, then as treasure, and finally as a means of payment. The government opposes this because it has an interest in the use of domestic currency through whose erosion of value it earns an inflation tax, and it introduces many prohibitions and penalties. This is the stage at which Thier's Law operates, as evidenced by the League of Nations: *"In advanced inflation, Gresham's Law was reversed: good money tended to drive out bad, and not the other way round; the reason being the irreducible need for a serviceable medium of exchange in any modern economy."* (Bernholz, 2003)

The scale of this substitution of good money for bad money was huge: "The substitution of the domestic currency by foreign media of payment progressed everywhere. In August 1923 in Germany this sum was estimated to amount to 2-3 billion gold marks. If this is correct, then the value of foreign currencies in German economic transitions was nearly ten times as large as that of the circulating paper mark notes." (Bernholz, 2003). This is a result of the undervaluation of domestic currency due to reduced real supply of money, since M/P drops due to faster growth of P relative to M, which is accompanied by a drop in real exchange rate. This is evidenced in the graph below. Paldam expressed this undervaluation of domestic currency under conditions of inflation through exchange rate and the ratio of prices in two countries and called it Bernholz' Law. Inflation has a tendency to accelerate once it has surpassed a certain level and it lasts till it is stopped. The higher the level of inflation the higher the variation, Paldam concludes (Bernholz, 2003).

Ernest Hemingway wrote about this period: *"There were no marks to be had in Strasbourg so we changed some French money in the railway station at Lehl. For 10 francs I received 670 marks. Ten francs amounted to about 90 cents in Canadian money. That 90 cents lasted Mrs. Hemingway and me for a heavy day of spending and at the end of the day we had 120 marks left! Because of the customs regulations, which are very strict on persons returning from Germany, the French cannot come over to Kehl and buy all the cheap goods they would like to. But they can come over and eat. It is a sight every afternoon to see the mob that storms the German pastry shops and tea places. Our first purchase was beside the main street of Kehl where we picked out five apples and gave the old woman a 50 mark note. She gave us back 38 marks in exchange. An old gentleman approached us and asked us how much the apples were. I counted the change and told him 12 marks. He smiled and shook his head 'I can't pay it. It is too much.' He went up the street I wish I had offered him some. Twelve marks, on that day, amounted to two cents. The old man, whose life's savings were probably, as most of the non-profiteer classes are, invested in German pre-war and war bonds, could not afford a 12-mark expenditure."* (quoted in Bernholz, 2003, p.82)

A separate problem for workers is bargaining over wages, which in the beginning is based on the expected rate of inflation, then on indexing, and finally using a foreign currency. Wages drop systematically, as shown in the figure below.

Fig. 3. Real wages of miners during German hyperinflation.



Source: P. Bernholz, p.97.

Stefan Zweig describes the situation for millions of unemployed workers: *"Unemployed men took one or two rucksacks during the Austrian hyperinflation and went from peasant to peasant. They even took the train to favourable locations to get foodstuffs which they sold afterward in the town at three- or fourfold the prices they had paid themselves. First the peasants were happy about the great amount of paper money which rained into their houses for their eggs and butter. When they came to town with their full briefcases to buy goods, they discovered to their chagrin that, whereas they had only asked for a fivefold price for their produce, the price for scythe, hammer and cauldron, which they wanted to buy, had risen by a factor of 50."* (quoted in Bernholz, 2003, p.98).

Prices grew unevenly, and those controlled by the state especially lagged behind:

Table 3. Chosen price indices during German hyperinflation, 1913-192(1913/14 = 1).

Date	Price index Cost of living	Price index Food	Price index Clothing	Price index Accommodation	Price index of railway fares	Price index of shares
October 1923	3,653 billion	4,301 billion	6,160 billion	54 billion	1,77 billion	171.3 billion

Source: P. Bernholz, 2003, p. 98.

The composer György Ligeti described the Hungarian hyperinflation: *"Ticket prices for trams in Budapest were adapted daily during the Hungarian hyperinflation, whereas those for railway tickets were changed only each fourth day. When I travelled one day to Romania, taking the streetcar in Budapest to the railway station was very many times as expensive as my journey by train to the Romanian border"* (quoted in Bernholz, 2003 p. 99).

Table 4. Expenditures for several goods during Austrian hyperinflation (first half of 1914 = 1).

Date	Housing furnished	Tram fares	Newspaper	Bread	Suit	Contribution to sickness insurance
September 1923	8,750	13,333	9,583	12,609	12,167	8,000

Table 5. Indices of different real weekly wages during the German Hyperinflation, 1913-1923 (1913 = 100).

Date	Unskilled railway workers	Skilled railway workers	Printers	Lower level civil servants	Middle level civil servants	Higher level civil servants
November 1923	62	46.4	54	69.9	49.5	38

Source: Bernholz, p. 100 and 101.

All this was due to inflation, which devastated real production.

Fig. 4. Trends of industrial production and real national product, Germany, 1913-1925.

Source: Bernholz, 2003 p. 102.

Stefan Zweig also wrote: *"Thousands of unemployed stood around and clenched their fists against the marketeers and foreigners in their luxury cars, who bought whole streets of houses like a box of matches. Nothing else has made the German people as embittered, as hateful, as ripe for Hitler as the inflation. For the war, as murderous as it had been, had at least seen hours of triumph, ringing of bells, fanfares of victory. As a consequence of the inflation Germany felt only drawn into the dirt, cheated and humiliated. A whole generation did not forgive the German Republic these years and preferred to call back its own butchers. Just because of the unexpected event that money, which had formerly been the most stable object, lost its value day by day, men estimated more highly the real values of life – work, love, friendship art and nature. Tho whole people lived more intensively than before in the midst of the catastrophe. We have never loved the arts more in Austria than during those chaotic years just because we felt that only the eternal within us remained as the really stable in view of the betrayal on the part of money."*(quoted in Bernholz, 2003, p. 104)

Journalist Sebastian Haffner described Germany in November 1923 as follows: *"Then something strange happened. One day the incredible story began to circulate that soon there would again be money of a 'stable value', and this became reality some time later: small ugly green-blue notes with the inscription 'eine Rentenmark'. When somebody first used them for payment, he waited somewhat surprised to see what might happen. But indeed they were accepted and he received his goods – goods with a value of one billion marks. The dollar no longer rose, nor did share prices. It became possible to still buy something on Thursday with the money which one had received last Friday. The world was full of surprises"* (quoted in Bernholz, 2003, p. 160). The situation was identical in Yugoslavia in January 1994, when the old 12 million dinars was replaced by a new one dinar. This transition eliminated other important features of the hyperinflation in a way that was not so obvious to the general public: 1) budget deficits, mostly from the war, 2) undervaluation of domestic currency to maintain exports at all costs, and 3) currency exchange 'dollarization'.

5. CONCLUSION

Instead of the idea of inevitability of progress based on the axioms of Newtonian mechanics, in line with Einstein's physics, Wallerstein points to the importance of uncertainty, the dominance of stochastic processes, and bifurcation - permanent dissolution and merging of the elements of the physical, and thus of the spiritual world as well. In such circumstances space and time have a different meaning: space is indivisible: there are no Newtonian individual bodies, but atoms and all possible subatomic particles collide and emit and receive energy. In the world of social sciences, space is no longer the movement of people and the existence of regions or countries, but only a global system - a unique global capitalist economy. Time is not mechanically repetitive, not a collection of "spotty events", but Fernand Braudel's analytical *longue duree*, with uncertain but inevitable duration as the only constant, and variable outcomes.

REFERENCES

Backhause, R. (1997), *Truth and progress in economic knowledge*, Edward Elgar.

Balibar, E., and Wallerstein, I. *(1991), Race, Nation, Class - Ambiguous Identities, Verso, London.*

Bernholz, P. (2003), *Monetary regimes and inflation, Edward Elgar.*

Collander, D., ed. (2000), *Complexity and the history of economic thought*, Routledge.

Hobsbawm, E. (1975), *The Age of Capital 1848-1875, Weidenfeld and Nicolson.*

Hodsgson, G. (2000), *Economics and utopia***,** Routledge.

Lavoie, M. (2009), *Introduction to post-Keynesian economics***,** *Palgrave Macmillan.*

Lawson, T. (1997), *Economics and reality*, Routledge.

Lipietz, A. (1985), *Enchanted World, Verso, London.*

R. Keohane, J. Nye, (2001) *"Realism and Complex Interdependence" Power and Interdependence, Addison Wesley.*

Stiglitz, J., and Serra, N., eds. (2008), *The Washington Consensus Reconsidered*, Oxford University Press, Oxford.

Šuvaković, Z*.* (2012)*, Politika, 24 January 2012, Beograd.*

Vane, H., and Snowdon, B. (2002), *An Encyclopaedia of Macroeconomics, Edward Elgar.*

Wallerstein, I. (1992)*, Unthinking Social Science, Polity Press, Oxford.*

Chapter 8

Global Monetary Policy Challenges After WWI

Dejan Šoškić*
E-mail: soskic@ekof.bg.ac.rs

Abstract: World War I was a turning point in global economics and finance. It was an event that led to the demise of the gold standard in the global financial system. Even before the war it was clear to many that the gold standard created output volatility as a result of new sources and production of gold. However, World War I was a turning point in the sense that even the strongest economies of the time could not support the system in the extraordinary circumstances created by the World War. Inflation was rampant in many countries, and the gold standard was suspended. After the war global relations were very different. The US has become the dominant global creditor. Germany had huge reparations to pay and did not recover its position in the global monetary system for years. Finally, monetary policy induced by the gold standard utterly failed when faced with the challenges of the Great Depression, putting an end to the gold standard as a global monetary policy rule. World War I had substantially changed the leading world economies' sovereign finances and distribution of gold reserves, and had set the stage for the demise of the gold standard and the creation of a modern post-WW II global monetary and financial system.

Key Words: Monetary Policy, Gold Standard, World War I, Great Depression

JEL CLASSIFICATION: N 140, N 120, E 520, E 580

World War I was an unprecedented military confrontation between major world powers, involving new, previously unseen military technology capable of causing massive loss of human life and destruction of the cumulated wealth of nations. In many respects it was a confrontation that defined and influenced the dominant events and processes of the 20th century, and also significantly influenced the balance of power and global framework of today.

Massive expenditure on all sides to finance the war, rampant inflation, huge budget deficits, depletion of reserves, and flight of capital from major European countries during the war substantially changed the economic and financial circumstances of the major economic powers of the day.

* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179005) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

This financial exhaustion of major countries involved in WWI caused a tectonic shift in the global financial system, substantially influencing the severity of the Great Depression and setting the stage for a fundamental change in Global Monetary Policy towards the modern monetary policy regimes of today.

1. PRE-WWI MONETARY POLICY: CLASSICAL GOLD STANDARD

In the decades before WWI the international monetary system was based on gold, and government issue of money was pegged to the amount of gold reserves. Gold was historical money. It was not just a 'barbarous relic': its use as money was a rational choice. It was durable, recognizable, ease to store, devisable, and easy to carry. Most importantly, it was not easy to produce in large amounts in a short time, and therefore could not be easily manipulated by governments. Gold was a commodity, and therefore the gold standard was based on commodity money, which in the long run tends to provide price stability since the purchasing power of a unit of a commodity should have an equalizing tendency with its cost of production in the long run.

Not all currencies where on the gold standard. It was a club of dedicated nations with a long-term interest in the stability of prices and exchange rates, and these exchange rates remained fixed to gold (and to any other currency that was fixed to gold), sometimes for decades. The British pound was fixed to gold with the same exchange rate from 1821 to 1914 and the US dollar was fixed to gold with the same exchange rate from 1834 to 1933[1]. Therefore the pound and the dollar had a fixed exchange rate of $4,867 to the pound (through gold) for decades before WWI.

How did the classical gold standard operate?

In theory, if there were any disturbance in the level of prices in one country (for example, due to an increase in productivity based on technological advances), in a gold standard system it would be automatically transmitted to other countries via the so-called price-specie-flow mechanism. The lower price of goods in one country would create more exports and fewer imports, and therefore a surplus in the balance of payments. With this surplus, gold would flow into the country producing an increase in money supply, gradually reversing the initial fall in prices. On the other hand, outflow of gold from balance-of-payments deficit countries would decrease the money supply in those countries, decreasing prices and re-establishing the balance of payments equilibrium at a fixed exchange rate. All the countries in the system would have somewhat decreased prices in the new equilibrium, compared to the initial drop in prices in one country. The system, therefore, could

[1] With the exception of the post-civil war years, the so-called Greenback era.

only provide long-term price stability for the group of countries in the system by maintaining the fixed price of gold in every country.

Before WWI, gold-standard countries wanted to limit the amount of gold per unit of GDP in the system and to limit the potential negative deflationary impact on their economies in periods of adjustment. So, in practice, one unit of gold was supporting multiple units of domestic money, but this ratio was fixed, and the system was still operational.

As a rule, capital flows always go where they can find a higher real rate of return. In the pre-WWI world it was normal for capital to go from lower real-rate-of-return countries (Britain, France) to higher real-rate-of-return (developing) countries (US, Canada, Australia). This flow of capital also meant a flow of gold, and, with the increase of gold in developing countries, their money supply was on the rise, and so were their price levels.

As a result their domestic export prices were rising compared to import prices, producing current account deficits that were financed by long-term capital flows from abroad.

In a classical gold standard a country does not need a central bank per se. And indeed, many of the countries in the system did not have one (US, Canada…). Still, central banks in the system can help by following the rules of the game to influence the cost of borrowing and to facilitate a swift adjustment of money supply and prices to flows of gold. In times of balance of payment deficits, a central bank should increase the cost of borrowing and therefore reduce domestic spending and price levels and attract capital flows from abroad.

Before WWI the United Kingdom was the dominant player and the central country in the gold standard. London was the centre for international payments and the money market and the Bank of England held most of its reserves in gold. Other countries had a combination of gold and sterling in their reserves. In the last years before WWI some smaller countries in continental Europe started keeping French francs and German marks as well, since their trade was increasingly with Germany and France. In this system the Bank of England was a central institution in the global monetary system, but did not need to keep large gold reserves. Flow of actual gold was limited by the fact that payments could be made in sterling on the London[2] money market. Besides, short term capital flows facilitated the balance of payments adjustment mechanism, and the gold itself was increasingly just 'earmarked' to the name of a new owner without leaving the place where it was kept safe in the major financial centres. Thus the reality of the pre-WWI gold standard was far from the theoretical model described above, and was often referred to as a sterling standard[3].

[2] In later stages of the pre-WWI gold standard system, payments were also made in other currencies and on markets in Paris, Berlin, and New York.

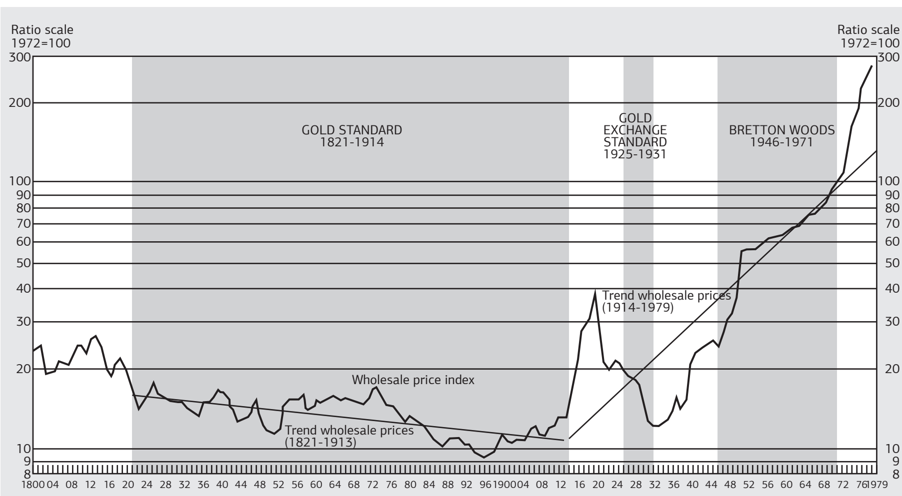
[3] See Williams, D. 1968.

The system had serious embedded flaws. Volatility of inflation and output were higher in the short run. The supply of money was determined not by the rates of economic growth but by the amount of available gold and could not be adjusted in response to economic needs. New sources of gold would increase money supply and inflation and decrease interest rates; the opposite of what modern central banks would do to provide stable economic growth. A shortage of gold in comparison to economic growth would create deflation and a suboptimal rate of growth, incapable of delivering potential employment in the economy.

Forceful maintenance of fixed exchange rates would transmit both shocks and/or good or bad policies from one country to others in the system. Despite the backing of gold, the gold standard did not prevent currencies from being targets of speculative attacks, and financial panics occurred regularly despite the fixed exchange rates and convertibility of money into gold.

However, for over thirty years prior to WWI the gold standard delivered relatively high rates of growth and predominantly free movement of goods, capital, and even labour. The gold standard had proved capable of providing price stability in the long run (Figure 1). Price risks deriving from exchange rate movements were practically unheard of. The relative success of the system pre-WWI was not based solely on the management of the Bank of England but also on the multicentre character of the system, in which the core countries of Britain, France, and Germany successfully coordinated their actions and persuaded the international financial community that they would do whatever it took to maintain convertibility to gold. This was possible because the relative independence of central banks from fiscal

Figure 1. Wholesale Price Index in the UK 1800–1979



Source: Bordo, M.D., 1981, p.8

authorities was already established and political influence in central bank business operations was limited.

The leadership and commitment of central banks was coupled with international cooperation and serious 'firepower' in terms of the gold reserves available to preserve the system. The central banks of the core countries cooperated regularly in terms of policy rates, loans, and liquidity maintenance. Peripheral countries adhered to gold standard rules for fear of losing access to London's deep financial markets.

However, things were about to change radically.

2. WORLD WAR I: FINANCIAL AND MONETARY IMPLICATIONS

The rosy picture of the gold standard system ceased to exist when the war broke out. After the assassination of Archduke Franz Ferdinand in Sarajevo panic sales shut down the Vienna stock exchange on July 13th. When Austria issued an ultimatum to Serbia on July 24th and when war broke out between Austria and Serbia on July 28th the scramble for liquidity began. By July 30th all the continental stock exchanges except Paris were shut. The panic shifted to London. The gold reserves of the Bank of England were depleted dramatically despite a 10% hike in interest rates. In a matter of days, by the end of the first week after Austria declared war on Serbia, the Berlin, Paris, London, and New York exchanges were shut down in order to prevent massive bank liquidations, since their lines of credits were extensively collateralized by securities. The governments of most of the major countries responded by offering a moratorium on payments to debtors[4], and a limit to deposit withdrawals. All of the core countries of the pre-WWI gold standard dropped out of the system[5].

World War I was an unprecedented conflict with horrific consequences in terms of loss of human life. At the same time the conflict caused unparalleled economic destruction, not just of the leading European powers' industrial capacity and infrastructure but also of the financial system that had operated so well before the war. None of the parties to the war had adequate provision for a long war, so the war effort had to be financed from currently available financial resources. To different degrees, the budget deficits in all of the major powers in the war were financed by the central banks.

However the magnitude of central bank involvement was different.

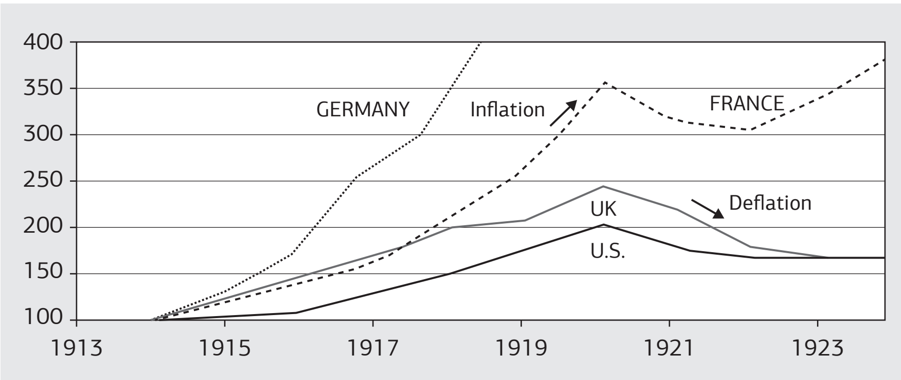
4 See Eichengreen, Barry, 1995.

5 Even the US, with short- lived restrictions on free movement of capital, can be treated to have left the system from 1917 to 1919.

Countries that could borrow to finance their part in the war did so, but borrowing was very limited. Even the traditional creditor countries like Britain and France were less and less able to provide loans. Nor were they able to collect on loans issued previously. Britain, the traditional banker of the previous era, was itself now forced to take on debt by borrowing from the US. France was in a similar position. Thus, the US became the major global creditor.

Germany had even fewer possibilities. Despite substantial pre-war financial reserves, it soon found itself in a position where the monetization of public debt, i.e., printing money, had become the dominant source for financing the war effort. Paper money was issued in large quantities in all of the major powers, but Germany led the way. Inflation was unavoidable (Figure 2). Even in the US, the country least affected by the war, prices doubled during WWI.

Figure 2. Consumer prices: 1913-1924 (1914 = 100)



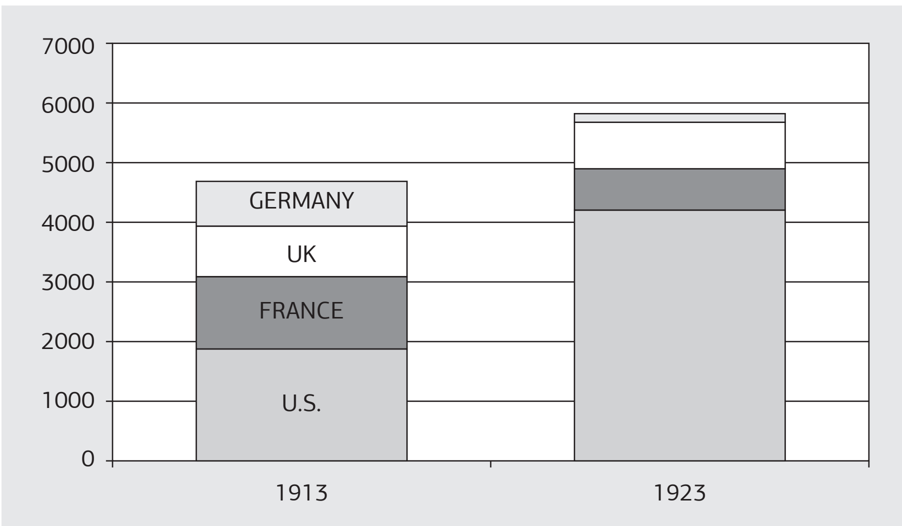
Source: Ahamed, 2010, p.158

United States did not just become a global banker. Its untouched industrial capacity grew substantially during the war, supplying war provisions to the Allies. The US was exporting far more than they were importing, and were now running a substantial trade surplus with the major European powers. New technologies and increased productivity shifted the US economy from a traditional producer of primary products to an industrial producer. At the same time the United States became a global financial safe haven. Gold was pouring in, and the pre-WWI gold distribution changed substantially in favour of the US (Figure 3.). This was a problem for both the European powers and the US, but it was also a serious problem for the potential reestablishment of the gold standard after the war.

The core gold standard countries from before the War were now running budget deficits, and were with insufficient gold reserves, huge war debts to the US, high inflation, and substantially higher prices than the pre-war level. Germany's reserves were almost completely depleted, inflation was rampant, it was politically unstable, and was faced with huge war reparations. The United Kingdom, the major pillar of the pre-war gold standard, had lost its status as world banker, and the Bank of England had only limited gold reserves. France was in continuous political turmoil with a large budget deficit and the franc substantially losing ground to the dollar.

The US, previously the leader of the peripheral countries of the gold standard system, found itself in a dominant global financial position. However, the natural new leader of the post-war gold standard found itself in a position of relatively week institutional capacity. The US Federal Reserve had just been enacted in 1913 and started its operations in 1914. The internal governing structure, with the division of power to 12 federal district banks and the Board of Governors, which was intended to limit the concentration of power in one centre, also hampered competent and swift decision-making. This was not an ideal vehicle for the new global leader of the financial world. Internal power struggles between the New York Fed and the Board in Washington were ongoing throughout the years when the new global financial leader should have been directing the new gold standard.

Figure 3. Gold reserves of major economic powers 1913-1923 (in $ million)



Source: Ahamed, 2010, p. 162

3. POST-WWI MONETARY POLICY: THE GOLD STANDARD REVISITED

It took more than a decade to reconstruct the central elements of the international financial system and to re-establish the gold standard. It did not take much to realize that this gold standard episode was far less resilient than its pre-WWI predecessor. The return to a gold standard was widespread but not long-lasting (Table 1). WWI had left in tatters the two most important elements of the pre-WWI gold standard, credibility and cooperation.

The core countries of the new system had to join the gold standard club with sufficient gold reserves and at an adequate exchange rate. The issue of exchange rate parity to gold was complicated: it was a choice between devaluing the currency and deflating prices in the economy. These bitter choices had very much to do with credibility and social distribution of wealth. Devaluation would hurt the credibility of the countries' commitment to the exchange rate but would improve

Table 1. Dates and Changes in Gold Standard policies after WWI

Country	Return to Gold	Suspension of Gold Standard	Foreign Exchange Control	Devaluation
Australia	April 1925	December 1929	–	March 1930
Austria	April 1925	April 1933	October 1931	September 1931
Belgium	October 1926	–	–	March 1935
Canada	July 1926	October 1931	–	September 1931
Czechoslovakia	April 1926	–	September 1931	February 1934
Denmark	January 1927	September 1931	November 1931	September 1931
Estonia	January 1928	June 1933	November 1931	June 1933
Finland	January 1926	October 1931	–	October 1931
France	August 1926 – June 1928	–	–	October 1936
Germany	September 1924	–	July 1931	–
Greece	May 1928	April 1932	September 1931	April 1932
Hungary	April 1925	–	July 1931	–
Italy	December 1927	–	May 1934	October 1936
Japan	December 1930	December 1931	July 1932	December 1931
Latvia	August 1922	–	October 1931	–
Netherlands	April 1925	–	–	October 1936
Norway	May 1928	September 1931	–	September 1931
New Zealand	April 1925	September 1931	–	April 1930
Poland	October 1927	–	April 1936	October 1936
Romania	March 1927 – February 1929	–	May 1932	–
Sweden	April 1924	September 1931	–	September 1931
Spain	–	–	May 1931	–
United Kingdom	May 1925	September 1931	–	September 1931
United States	June 1919	March 1933	March 1933	April 1933

Source: Bernanke, Ben, Harold James, 1991, p 37, according to the League of Nations Yearbook, various dates, and miscellaneous supplementary sources.

the competitiveness of the economy and shift value from creditors to borrowers and taxpayers. Deflation would bolster credibility but hurt the economy and its competitiveness, and would shift value from debtors and taxpayers to creditors.

The US chose to continue with the pre-WWI exchange rate. It was an obvious choice since its level of gold reserves was high, and prices were not vastly different from pre-WWI.

On the other side of the spectrum of major players, Germany also had an easy choice. After rampant inflation ended in 1924, it gradually and with limited reserves, stabilized the currency and returned to the standard, but with enormous devaluation compared to the pre-WWI system.

France had undergone a period of fiscal instability with large budget deficits, but also with huge depreciations and swings in the value of the franc against the dollar. They realized that depreciation had increased the demand for French goods and services abroad and that they had acquired new markets traditionally dominated by Britain and other countries. Knowing that deflation could make them less competitive and having experienced relatively high inflation, the French decided not to deflate but to depreciate the franc to a slightly undervalued level that they could easily defend, in order to preserve the ongoing economic growth and increasing competitiveness.

The UK was faced with a difficult choice. Devaluation of the pound would be a blow to its credibility and prestige as a global financial centre and the manager of the pre-WWI gold standard system. On the other hand, prices had significantly gone up since 1913 and deflation would be difficult and painful. The UK opted to try to reassert its predominance as a financial centre by seeking to deflate and re-establish the pre-WWI parity of the pound against gold. This reassured global creditors and put a necessary prerequisite for the nominal leadership of the system back in the hands of the UK. This time, however, circumstances were very different to those pre-WWI.

Britain had neither the gold nor the economic power of the pre-war era. It was indebted to the US and incapable of collecting the debts owed to it by other countries. An increase in minimum wages enacted after the war with the pound overvalued and high interest rates made Britain uncompetitive compared to France and other countries. The UK economy was stagnating, with high unemployment and low competitiveness. From a pre-WWI creditor country with a surplus it became a deficit country and a borrower, and not a country with the financial capacity and credibility needed for the role of leader of the new gold standard system.

The gold standard after WWI had several technical shortcomings[6].

First, and probably most important, surplus countries did not fully stick to the rules of the game. There were no sanctions if surplus countries did not increase their money supply according to the price-specie flow mechanism. They could ster-

6 See Bernanke, Ben, Harold James, 1991.

ilize gold inflows, as France was doing, and accumulate reserves beyond reasonable amounts, sucking out the gold necessary for the other economies in the system. Before WWI Britain had been a surplus country, but attitude of the Bank of England was different: as a profit-motivated institution it did not hold excess gold since it was not an interest-bearing asset. After WWI the two major surplus countries, the US and France, had central banks that had a different attitude and no problem with accumulating gold. Since the deficit countries stuck to the rules, decreased their money supplies, and deflated in order to prevent the loss of reserves, the whole system had a deflationary bias.

Secondly, many of the new central banks (including the Federal Reserve) had a fixed percentage of gold backing the notes supplied. This gold was in effect unusable as a reserve to settle temporary BOP imbalances as it was in use to back the issued paper money. Therefore the money of deficit countries contracted very soon after they started losing gold, adding to the deflationary bias.

Thirdly, a fixed percentage backing for gold of, for example, 40%, meant that a payment of \$1 in gold meant a decrease of \$2.5 in money supply. Again, loss of gold has an immediate deflationary impact, not accompanied with an adequate inflationary impact in the surplus country. Again, another deflationary bias of the system.

Fourthly, the system's peripheral countries were encouraged to hold part of their reserves in the core countries' convertible currencies as a substitute for gold. Since the backing of these convertible currencies with gold was just fractional, any shift of the peripheral central banks from currency to gold lowered the global money supply. Since this was likely in times of uncertainty there was an invisible and unintentional global mechanism for a deflationary response to crisis situations.

Finally, most of the European central banks could not conduct open market operations by statutory restriction. This was the legacy of government debt monetization during the war, and was intended to prevent misuse of monetary policy and potential future inflation. This was especially the case with German memories of the 1923 inflation, which made that country almost paranoid in its subsequent attachment to deflationary policies.

The financial weakness of the UK and lack of institutional readiness of the US for a leading role in the new gold standard system after WWI was not a good starting point. The credibility and cooperation so important for the success of the pre-WWI gold standard could not be re-established. Core countries of the new system had substantial and continuing differences on the issue of reparations and war debt. One of the major currencies was overvalued (British pound), one was undervalued (French franc), and one had ruined credibility (German mark). The system was not played by all according to the rules of the game, and it had an imbedded deflationary bias.

All this has led to the demise of the post-WWI gold standard soon after it had been re-established (Table 1).

4. MONETARY POLICY AND THE GREAT DEPRESSION

Post-WWI monetary policy based on the gold standard failed utterly, in light of the crisis of 1929. It not only contributed to the creation of the stock exchange bubble on Wall Street but to the depth of the crisis and its global spread.

It took almost a decade to try to re-establish the gold standard after WWI. It could be said that it was up and running just after the UK, the pre-WWI leader, joined. The decision to join at the pre-WWI exchange rate was a fruitless effort to support the credibility of the pound in what was now a different world. Britain's economy was struggling with low rates of growth and lost competitiveness, which was partly due to an overvalued pound in a new system. Britain was running current account deficits, owed war debts to the US, and was in a deflationary phase with relatively high interest rates supporting the pound. Meanwhile, the US did not experience immediate inflationary pressures and by the end of 1926 the Federal Reserve decided to cut the rates in order to support the pound in the system. This was done at a time when the rise in stock prices on Wall Street was still moderate and broadly in line with corporate profits. It is this action by the Federal Reserve that is considered[7] to have triggered the creation of the Wall Street bubble of 1929, and it was motivated by the operation of the international gold standard.

Once the Wall Street bubble was initiated it attracted capital inflows from abroad, forcing other countries to increase interest rates to try to preserve their gold holdings and causing their economies to slow down even before the market crash.

Subsequently, the Federal Reserve started raising rates to try to deflate the Wall Street bubble, but it was too late since the momentum was given over to irrational exuberance. Instead the increase in Federal Reserve rates, through the mechanism of the gold standard, further reduced economic activity in the system's member countries.

After the 1929 crash the recession in the US influenced all of its trading partners, but especially those in the gold standard system.

The Federal Reserve also was unable to act as a lender of last resort in the subsequent bank panic[8]. Nor was it able to substantially increase liquidity due to the fixed gold-backing rule of the gold standard and lack of eligible securities to conduct open market operations[9]. A separate institution was created in January

---

[7] See Wheelock 1992.

[8] Started with the Bank of the United States in 1931.

[9] See Wicker 1996.

1932, the Reconstruction Finance Corporation (RFC), delegated with the authority to lend to banks and other financial institutions. Only after this and after the Federal Reserve made relatively substantial open market purchases in mid-1932 did the first wave of banking failures started to decrease[10]. However, the US banking crisis revived several times and ended only when Roosevelt declared a national bank holiday in March 1933 and suspended gold shipments, which effectively ended the gold standard in the US[11].

The gold standard was a vehicle for transmitting the effects of the Wall Street crash through the international financial markets via the system's member countries. It also prevented the creation of liquidity when it was needed and contracted the available global money in times of heightened uncertainty and financial crisis. The gold standard was ineffective in dealing with bank panics and was a source of deflation and depression[12].

5. LESSONS OF THE POST-WWI MONETARY POLICY EPISODE

Valuable lessons can be drawn from monetary policy experience post-WWI, several of which are relevant to current monetary policy challenges.

5.1. Asset bubbles should not be neglected by monetary policy. As we know, monetary policy has been oriented primarily towards price stability. Research has shown that monetary policy is related to volatility in asset prices[13]. It should not come as a surprise that most of the asset bubbles have been accompanied by previous relatively low levels of inflation and therefore relaxed monetary policy with relatively low interest rates. Even in modern times, with inflation-targeting a dominant monetary policy paradigm, research suggests that it is important to monitor credit growth alongside expected inflation in monetary policy conduct[14]. Monetary policy neglect of asset bubbles has not just been a property of the gold standard and the Great Depression but, many would argue, has been the rule until the recent financial crisis of 2007/2008 and beyond. It is still an open issue how to effectively incorporate credit growth or asset price movements in a modern framework of inflation targeting in today's monetary policy.

5.2. Deflation of asset bubbles leads to recession. Even if we take just stock market crashes we see that they are highly related to recessions[15]. Recently, it has been clearly shown that economic slumps invariably follow severe financial crises

[10] See Friedman and Schwartz 1963.
[11] See Wheelock 1992.
[12] See Bernanke, Ben, James Harold 1991.
[13] See Bernanke, Ben and Mark Gertler, 2000.
[14] See Christiano, Lawrence, Cosmin L. Ilut, Roberto Motto, Massimo Rostagno, 2010.
[15] See Barro, Robert, and Jose Ursua, 2009.

for years after the initial downturn[16]. Market collapses are deep and prolonged with huge downward corrections in asset prices and wealth. If a financial crisis includes a banking crisis, and it most probably does, as in the Great Depression, then profound declines in output and employment (with rising unemployment) are unavoidable. Recession, as a rule, leads to an increase in the real value of government debt with potential for sovereign debt crises. A usual sequence of events is that a financial crisis is followed by capital controls, financial repression, inflation, and default[17]. A severe financial crisis is often followed with greater risk aversion, as was the case in the recent Eurozone sovereign debt crisis, with an immediate effect on the cost of borrowing and sustainability of public finance.

5.3. Fixed exchange rates transmit shocks through the countries in the system. The spillover of the crisis that started in the US, to the rest of the world via the gold standard was a good example for potential future crises fuelled by fixed exchange rates[18]. One could argue that the British pound crisis of 1992 was a typical example of shock transmission via fixed exchange rate. German unification created a shock with the combination of expansionary fiscal policy and tight monetary policy[19]. This was transmitted to the UK via the European Exchange Rate Mechanism (ERM) of fixed exchange rates[20]. Unlike what would be the case with the gold standard, the British pound devalued[21] and saved the UK from economic downturn as a consequence of tight monetary policy required to keep the Pound in the ERM. The Argentinean crisis of 2001 is a second prominent example: the Argentinean currency was fixed to the dollar via the currency board; appreciation of the dollar resulted in a fully-fledged crisis in Argentina. Finally, the prolonged European sovereign debt crisis could also be at least partly attributed to fixed exchange rates within the Eurozone. Member countries of the so-called Eurozone periphery have been left without the potential to devalue their currencies, improve their current account balance, and increase their competitiveness. Therefore there is a valuable lesson to be learnt from the Great Depression and the Gold Standard: it is best to avoid macroeconomic shocks, but when they occur it is best to suspend or discard the fixed exchange rate that links the shocked economy with other economies in the system.

5.4. Targeting an overvalued exchange rate in the long run is prone to cause financial stress. One could argue that this has been the case with many countries in the past decades, and that history is repeating itself. An obvious example of this phenomenon is the UK and the post-WWI Gold Standard. An overvalued exchange

[16] See Reinhart, Carmen M, and Keneth S. Rogoff, 2009.
[17] See Reinhart, Carmen M, and Keneth S. Rogoff, 2013.
[18] See Temin, Peter, 1993.
[19] Very similar to so called Reaganomics with the difference that dollar has appreciated against other currencies and German mark was tied within ERM to other countries.
[20] With narrow margins of fluctuations allowed.
[21] And some argue that if it has not left the ERM in 1992, most probably it would have been a Eurozone member today.

rate was accompanied with lower competitiveness and rising current account challenges, leading to a decrease in economic activity and employment and an increase in both absolute and relative national debt. Similar patterns have been observed in some Latin American countries in the 70s and 80s, culminating with Argentina in 2001. This pattern was relatively clear in Southeast Asia in the late 90s and in the so-called peripheral countries of the Eurozone in the late 2000s. The importance of the real exchange rate for the economic performance of emerging countries is evident[22], but some Southeast European countries with week institutional frameworks still opt for fixed and most probably overvalued exchange rates. Therefore, in some cases, clear historical lessons have still to be learned.

World War I has substantially altered the global financial system. It has been shown that monetary models of the past could not operate effectively in the new post-war environment, and that monetary policy needs to evolve with the changing world. The important lessons learned after WWI paved the way to modern monetary policy. Some of the lessons and ideas that came into existence after WWI are still valuable in and relevant to the contemporary world.

REFERENCES

Ahamed, Liaquat (2010), *Lords of Finance*, Windmill Books.

Barro, Robert, and Jose Ursua (2009), "Stock-Market Crashes and Depressions," *NBER*

Working Paper Series, Working Paper No. 14760.

Berg, Andrew, and Yanliang Miao (2010), "The Real Exchange Rate and Growth Revisited: The Washington Consensus Strikes Back?" IMF Working Paper, WP/10/58.

Bernanke, Ben S. (1993), "The World on a Cross of Gold: A review of 'Golden fetters: The gold standard and the great depression, 1919-1939' ", *Journal of Monetary Economics* 31 April, pp. 251-267.

Bernanke, Ben, Harold James (1991), "The Gold Standard, Deflation, and Financial Crisis in the Great Depression: An International Comparison", in R. Glenn Hubbard (ed.), *Financial Markets and Financial Crises*, University of Chicago Press.

Bernanke, Ben, and Mark Gertler (2000), "Monetary Policy and Asset Price Volatility", *NBER Working Paper Series,* Working Paper 7559.

Bierman, Harold (1991). *The Great Myths of the 1929 and the Lessons to be Learned*, Westport, Connecticut: Glenwood Press.

Bordo, Michael D. (1981), "The Classical Gold Standard: Some Lessons for Today", *Federal Reserve Bank of St. Louis Review*, May.

Christiano, Lawrence, Cosmin L. Ilut, Roberto Motto, Massimo Rostagno (2010), "Monetary Policy and Stock Market Booms", *NBER Working Paper Series*, Working Paper 16402.

Gnos Claude, Louis-Philippe Rochon (eds.) (2011), *Credit, Money And Macroeconomic Policy: A Post-Keynesian Approach*, Edward Elgar Publishing.

Eichengreen, Barry (1995), *Golden fetters: The gold standard and the great depression, 1919-1939*, New York: Oxford University Press.

Eichengreen, Barry, and Jeffrey Sachs (1985), "Exchange rates and economic recovery in

[22] See Berg, Andrew, and Yanliang Miao, 2010.

the 1930s", *Journal of Economic History,* No. 45, pp. 925-946.

Fisher, Irving (1933), "The debt-deflation theory of great depressions", *Econometrica,* 1 pp.337-357.

Friedman, Milton, and Anna J. Schwartz (1963), *A Monetary History of the United States, 1867-1960*. Princeton: Princeton University Press.

Kindleberger, Charles (1973), *The World in Depression, 1929-39*, Berkeley: University of California Press.

Kindleberger, Charles (1993), *A Financial History of Western Europe,* Berkeley: University of California Press.

Reinhart, Carmen M, Keneth S. Rogoff (2009), "The Aftermath of Financial Crises", *NBER Working Paper Series,* Working Paper 14656.

Reinhart, Carmen M, Keneth S. Rogoff (2013), "Financial and Sovereign Debt Crises: Some Lessons and Those Forgotten", IMF Working Paper, WP/13/266.

Temin, Peter (1993), "Transmission of the Great Depression", *Journal of Economic Perspectives*, Volume 7, Number 2, Spring pp.87-102.

Wheelock, David (1992), "Monetary Policy in the Great Depression: What the Fed did and Why", *Federal Reserve Bank of St. Louis Review*, March.

Wicker, Elmus (1996), *The Banking Panics of the Great Depression*, Cambridge: Cambridge University Press.

Williams, David (1968), "The Evolution of the Sterling System", in C.R. Whittlesey and J.S.G. Wilson (eds.) *Essays in Money and Banking in Honor of R.S. Sayers*, Clarendon Press.

Chapter 9

Economic Possibilities for Keynes's Grandchildren

Mihail Arandarenko*
E-mail: arandarenko@ekof.bg.ac.rs

We read the letters of the dead like puzzled gods -
gods nevertheless, because we know what happened later

...Everything they foresaw has happened quite differently,
or a little differently - which is the same thing.
The most fervent stare trustingly into our eyes;
by their reckoning, they'll see perfection there

Wislawa Szymborska (1923-2012): *Letters of the Dead*, translated by Vuyelwa Carlin

Abstract: Some dozen years after the end of WWI, on the eve of Great Depression, Keynes famously predicted that the economic problem – the struggle of humankind to secure the necessities of life - in advanced ('progressive') countries would be solved within a century. His centennial prophecy also included a 15-18 hour working week, to make room for more enlightened leisure. There is a near consensus among economists that Keynes was almost right about the former, and quite wrong about the latter. This essay examines a growing body of literature on what we call Keynes`s prophecy in order to present available empirical evidence on trends in GDP and working hours, and to systematize criticism of aspects that Keynes refuted or neglected and of his vision of future society. An attempt is made to broaden the range of issues which need to be considered to make a full assessment of Keynes predictions at this point in time. Finally, we try to identify key developments that could facilitate eventual fulfilment of Keynes`s prophecy.

1. KEYNES'S PROPHECY

Economic possibilities for our grandchildren (henceforth EP) was published in 1931 in the collection *Essays in persuasion*. It is a short essay, written somewhat carelessly, and economists have long considered it to be insufficiently serious and

* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179065) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

somewhat fanciful (Skidelsky & Skidelsky, 2013). However, this short piece evolved over a number of years. The early versions of EP, delivered in lecture form, mostly to student associations, date back to the beginning of 1928. Its text was thoroughly revised for a lecture given in Madrid in June 1930 to add a reference to the Great Recession (Pecchi and Piga, 2008).

The tone of EP is emphatically optimistic. The opening sentence of the essay is not about the prevailing world depression of the time it was written, which Keynes had predicted elsewhere. Instead, Keynes immediately discards "the bad attack of economic pessimism" caused by the depression. "We are suffering", Keynes continues, "not from the rheumatics of old age, but from the growing-pains of over-rapid changes, from the painfulness of readjustments between one economic period and another" (Keynes, 1931). Quickly abandoning contemporary debates, Keynes looks at secular economic trends in an attempt to answer the key question of the essay: what would economic conditions be in a hundred years?

At some not so distant point, starting from around the late 16th century, advanced countries were for the first time in human history able to overcome the lack of the capital necessary for growth. Sustained capital accumulation had led, over time, to the expansion of technical improvements and foreign investments. Economic growth, which hitherto had been non-existent or sluggish at best, started to accelerate, and powerful engines of science and compound interest were put in motion to jointly produce a prolonged, self-sustained growth. Sometimes the growth engine slows down or stops, sometimes it gets overheated, driven either by a bubble produced by avarice or by great innovations, but, in the long run, capital and national income increase by around 2% annually on average. This seemingly modest rate is enough to increase capital and income by a half in only twenty years, and seven and a half times in a hundred years.

To be on the safe side, Keynes predicted that one hundred years on, in around 2030, the standard of living – at least in "progressive" countries (the United Kingdom, the United States, and most of continental Europe) would increase at least fourfold, and more likely eightfold. Given the contemporary living standards in advanced countries, this increase would be enough to provide universal fulfilment of people's "absolute" needs. Keynes admits that "relative" needs – those needs which, if fulfilled, make us superior to our fellows – might be insatiable. But the saturation of absolute needs would be a strong enough incentive for most human beings to turn their attention and energies to non-economic purposes and to devote themselves to the art of living. Freed from long working hours, people would need to learn how best to use their extended leisure time.

This is the second, more contested part of Keynes prophecy. Technological progress and individuals losing interest in increasing their incomes after their absolute needs are decently met will jointly work toward a significant reduction in working hours. Moreover, this reduction might turn out to be a good and indeed necessary remedy for 'technological unemployment'. By invoking the income effect caused by increasing real wages, Keynes, as a master of ambiguity, somehow managed to avoid being accused of the 'lump of labour' fallacy, one of the mortal sins for today's labour economists. "… We shall endeavour to spread the bread thin on the butter to make what work there is still to be done to be as widely shared as possible. Three-hour shifts or a fifteen-hour week may put off the problem for a great while. For three hours a day is quite enough to satisfy the old Adam in most of us!" (Keynes, 1931).

Keynes could have formulated his prediction largely as a projection based on empirical information: the average annual number of hours worked per worker fell by almost 30% between 1870 and 1930, both in Europe and the United States, as part of an even longer development. Using historical data on GDP and hours worked since 1889, Ohanian (2008) develops a standard growth model to shed light on Keynes`s working-time forecast. He finds that the model generates a 40% decline in hours worked between 1929 and 2006, and a 54% decline between 1929 and 2020, which is not so remote from Keynes`s prediction of a 67% decline.

Toward the end, the essay at times takes, ironically, almost a biblical tone of redemption and salvation, moderated by casual jokes and careful scientific disclaimers. The transition from the time in which avarice, usury, and precaution are still useful virtues to the time in which the love of money again becomes detestable and ends are valued above means, will of course be gradual, and will take at least another hundred years. "There will be ever larger and larger classes and groups of people from whom problems of economic necessity have been practically removed" (Keynes, 1931). The pace of that transition, which presumably will be the greatest in human history, will depend on four main factors: control of population growth, absence of war and civil dissent, speed of technological progress, and the rate of accumulation, which, if the former three are successfully resolved, should not by itself be a problem.

Still, the steady state of Keynes`s Utopia remains somewhat ambiguous – will growth continue at a 15-hour working week, or not? Is this Utopia a zero-growth society, or will the engine of compound interest continue to work as a perpetuum mobile, only perhaps slower without the fuel of human avarice? Pecchi and Piga (2008) argue that Keynes envisaged a complete halt in the growth of GDP per capita once the adequate standard of living is achieved for all, but it is difficult to find explicit confirmation of this understanding in EP.

2. ASSESSMENT OF QUANTITATIVE PREDICTIONS

GDP growth

Most authors agree that Keynes's GDP growth rate forecast of between 1.4% and 2.1% per capita across the developed countries was very (eerily, as Ohanian (2008) put it) accurate. According to Ohanian, this is even more astonishing as nothing close to a modern growth theory existed at the time when Keynes formulated his prophecy. In that respect Keynes was at least a quarter century ahead of his time (cf. Solow, 1956 and Swan, 1956). His far-sighted optimism is even more laudable since at the time of writing EP his native United Kingdom had experienced prolonged economic troubles for as long as two decades and was sinking, with the rest of the world, into the Great Depression.

Worldwide, the growth rate exceeded Keynes expectations, at least in the second part of the 20th century for which the data are more widely available. Thus, using the Penn World Tables, Zilliboti (2007) calculated global population-weighted GDP growth rate in the half-century starting from 1950 at 2.9%. Stiglitz (2008) points out that Keynes actually underestimated, by an order of magnitude, the pace of innovation and capital accumulation: think of modern-day China with an average growth rate of over 9% over 30 years.

Work-time reduction

Although it is clear that Keynes`s predictions of a sharp reduction in working hours did not materialize (and most likely would not until 2030), some reduction did occur. However, for a correct assessment, it would be mistaken to simply compare standard or average hours of work back in 1930 and today. In order to compare comparable measures, several adjustments need to be made. Because of increased paid vacation time, it is better to use the annual amount of hours worked and to divide it by 52. Furthermore, because of the expansion of years spent in education (and the development of legislation prohibiting child labour), spread of pensions (still relatively rare in 1930s), and expansion in life expectancy it would be even more correct to compare lifetime workloads. Then, moving from individuals to families, it is important to account for the slight reduction in employment rates of prime-age males and significant increase in female employment rates.

Roughly following the above considerations, Zilibotti (2007) provides some 'back of the envelope' but very useful calculations. Of course, his calculations are based on cross-section observations rather than panel data. Keynes forecast that the average individual would work 7.6% of their lifetime by 2030, while by contrast, in Zilibotti`s stylized "2000 real world", an average individual works 14.4% of their overall time budget in the case of a 30-hour working week (broadly matching European reality), and as much as 18.3% of the 38-hour working week (matching US experience). The distinction between Europe and the U.S. is necessary because of diverging trends in Europe (which continued to follow Keynes`s forecast but much more slowly) and in the USA, which actually recorded an increase in hours worked between 1970 and 2000. While in the mid-1970s Europeans worked slightly more than Americans, by 2000 they worked only around 75% of the time Americans spent working (Zilibotti, 2007).

The fact that Americans work much more than Europeans, despite having higher GDP and thus supposedly being closer to fulfilling Keynes`s forecast, is often used as an empirical argument against it. But what if this is a part of a more general pattern, which could be different from the one suggested by Keynes, in which increasing GDP provides for a gradual reduction in work hours?

Looking at the comprehensive ILO statistics on employment rates in major world regions, it becomes apparent that world regions with the highest employment rates are those with the lowest and the highest GDP. The world's lowest employment rates are to be found in middle-income regions such as North Africa, the Middle East, the Caucasus, and South East Europe. Possibly there is something of an employment (and working hours) U-curve, or an 'inverse Kuznets curve' - high employment rates in underdeveloped countries because of low productivity and income, then declining as the countries create modern sectors and move to middle-income territory (increasing income inequality in the process), and finally again increasing employment as the proportion of good jobs increases and countries move to high-income territory. Still, employment rate might be a less than perfect proxy for hours worked because of lower standard hours and widespread part-time work in developed countries.

In any case, people certainly work more today than Keynes expected, but it is still less than around 1930. Furthermore, a reduction in time spent on housework has freed up additional time for leisure activities. This has been facilitated by the widespread availability of basic facilities such as running water, central heating, and timesaving electrical appliances such as washing machines (which according to Chang (2010) changed the world more profoundly than the internet), refrigerators, vacuum cleaners, etc.

3. CRITICISM OF KEYNES'S IDEAS AND NEW EXPLANATIONS OF SOME DIVERGING TRENDS

EP is written in a casual, uneven style, possibly intentionally to temper its prophetic undertone. The economist, philosopher, prophet, and entertainer in Keynes are jointly present in almost every section, although in uneven proportions. Some claims are quite provocative, and at times politically incorrect by today`s standards – such as casual remarks about Jews, rich housewives on the brink of a nervous breakdown, and the like. As the volume edited by Pecchi and Piga revisiting Keynes`s essay shows, at times Keynes`s style confuses and even annoys modern economists, used to a more ordered and substantiated exposition.

But, seemingly anticipating criticism, Keynes perhaps intentionally immunized some of his key propositions and predictions using ambiguous language and passing remarks. Most of his propositions are expressed in a form that is not easily refuted, and are further counterbalanced by qualifications and alternative ideas, often scattered elsewhere in the text.

Nevertheless, there are two main types of criticism, the first addressing alleged logical and methodological weaknesses and omissions in Keynes`s reasoning, as well as his personal biases and idiosyncrasies, and the second identifying processes and developments that turned out differently than predicted, and which Keynes could not possibly have known at the time of writing (but most of which he at least implicitly included in the four-preconditions immunizing disclaimer at the end of EP).

Neglect of within-country distributional issues

As in his other writings, Keynes pays little attention to distributional issues. Keynes's forecast is based on the assumption that with technical progress, real wages will always increase. Some critics find it to be one of the major weaknesses of his reasoning in the EP. For example, Solow (2008) reiterates that the distribution of income and output between labour and capital depends on the ease with which the former can be substituted for latter. If the elasticity of substitution is relatively high, profits will over time absorb an ever-increasing share of aggregate income. More recently, based on long term analysis of empirical trends in within-country distribution in advanced countries, especially the income share of the top 1% earners, Piketty (2013) made an even stronger proposition: as long as the rate of return on capital exceeds the rate of growth, the income and wealth of the rich will grow faster than the income from work.

In a thought experiment, showing that the future could bring developments entirely opposite to Keynes`s forecast, Solow presents an extreme case in which production is performed almost entirely by machines or robots. In such a case the share of wages becomes negligible, and workers survive only if they are also capital owners.

Neglect of cross-country inequality

Not only does growing within-country inequality in advanced countries work against the fulfilment of Keynes`s prophecy, but also the widening gap between rich and poor countries. Looking at the growth dynamics in the second half of the 20th century, Zilibotti (2007) finds that the growth performance of world regions does not follow a pattern of convergence. Moreover, at the beginning of the 21st century, “some 50 percent of the world still lives on less than two dollars a day, some one billion still lives on less than a dollar a day” (Stiglitz, 2008).

Neglect of some important secular impediments to growth

It could be argued that Keynes`s optimism shows in the asymmetry of his reasoning – while he subscribes to the law of diminishing utility of income, he does not believe in the law of diminishing returns to capital and does not take into account how exponential growth interacts with finite resources, the issue first fully addressed by the Club of Rome (1972). Coincidentally, the post-history of Keynes`s grandchildren starts at 2030, the same year that marks the collapse of the growth engine in one of the main scenarios of the ‘limits to growth’.

Contributors to the Pecchi and Piga book single out as important impediments to growth global climate change and the constant danger of local or global wars and terrorism due to the growing availability of weapons of mass destruction (Baumol 2008).

Absolute needs not so easily satiable – drive for new products, quality, and perfection

Keynes makes only a general point that a fourfold or eightfold increase in living standards would make most people in the industrialized countries of his time fully satisfied, implicitly assuming an unchanged level of inequality. It has been argued that this underestimates the limits of absolute need, for a number of reasons. First, even the needs for which there is a natural optimum, such as daily calorie intake, could be satiated by very different products, implying a wide variation in costs. For example, consumption of meat and fruit rapidly increases in rapidly growing developing countries such as China and India, while consumption of high-quality wines continues to increase in France year by year, despite the reduction in total wine consumption.

Second, and probably even more important, technological progress not only improves the quality of existing products but by its very nature creates entirely new ones – think of the innovations introduced in almost every home in the developed countries during the past 100 years: cars, air conditioners, television sets, washing machines, blenders, home computers, mobile phones, etc.

Another factor contributing to the vast expansion of absolute needs is the increasing sophistication of consumers. They strive for quality, safety, and top performance – organic food, tailor made suits, cashmere sweaters, fast and comfortable cars, granite countertops, double- or triple-glazed windows.

Underestimating the power of relative needs – keeping up with the Joneses

There is only a subtle demarcation line between 'striving for perfection' and 'keeping up with the Joneses'. In a very affluent society it often becomes nearly invisible – do people buy Nike sneakers, designer clothes, Louis Vuitton handbags, iPhones and Lamborghinis because they want the best available quality within their budget constraint or because they do not want to feel inferior to their neighbours and colleagues? In other, especially less sophisticated settings, that demarcation line is much more pronounced. Still, most economists believe that demands originating in the wish to feel superior to one`s peers are not overly important in the bigger picture.

Culture of consumerism

But, as Stiglitz (2008) explains, it could be probable that changing and growing preferences for consumer goods are endogenous to the modern growth engine, diverting it from its eventual landing as conceived by Keynes. Discarding Keynes`s predictions as generally wrong, Stiglitz focuses on the example of the U.S. as an extreme case. In 1970 working hours in major European countries and the U.S. were almost the same. By 2000 Americans were working almost 40% more than the French, Italians, and Belgians. In absolute terms, average hours worked per person of working age (thus including the unemployed and inactive) per week in the US went from 24 in 1970 to 25 in 2000 (Stiglitz, 2008). Despite solid growth in the same period, for the vast majority of Americans there was no improvement in the direction suggested by Keynes. On the contrary, individuals and families on average could even have been worse off. Stiglitz identifies elements of dysfunctional behaviour such as an epidemic level of obesity and workaholic patterns of behaviour, where individuals work so hard to get what they view as the life necessities for their families and that they then have no time to spend with them.

Harried leisure class

Stiglitz`s views echo those of Galbraith (1958) and Linder (1970), who claimed that consumers in rich countries had become harried in a futile attempt to increase the productivity of their time when not working. Linder`s thesis is that in order to increase the productivity of leisure time, people prefer activities whose productivity can be increased with more goods, as well as those which can be done in parallel. Consumers become more productive in 'consumption' of their leisure time if they use more, and more expensive, gadgets per time unit. Purely maintenance activities, whether related to appliances or health, are neglected since they do not contribute intensively enough to our pleasure. Instead, modern consumers replace perfectly repairable items with new ones and take drugs or undergo surgical procedures to save the trouble of eating and exercising properly. Ironically, they might find themselves spending a lot of time maintaining their expensive gadgets – for example, swimming pools or yachts.

Work as joy and challenge

Although some authors from Pecchi and Piga's volume attack Keynes for his "snobbishness" or the "aristocratic views" typical of his Bloomsbury circle, he essentially, only in a more vivid fashion, reiterates what has long been the standard approach of economic theory, which treats work as a burden and opportunity cost of any income from labour. Stiglitz (2008) rightly points out that the textbook economic model of the allocation between work and leisure (even if home production is analysed separately from consumption) is fundamentally flawed because it does not recognize the enjoyment of work, either in the market or in home production. In many real life situations it is hard to distinguish if an activity should be classified as work or leisure, because it contains elements of both.

Apart from providing for subsistence, work brings many well-recognized benefits for personal development. Creative work may provide meaning in life. In jobs which are not creative or pleasant in themselves, social interaction might bring significant pleasure. Freeman (2008) claims that in the order of 40% to 60% of American workers have dated someone from their office. Even the most repetitive jobs might have calming and soothing properties. Inversely, the negative effects of prolonged unemployment on individuals have been extensively documented.

Pecchi and Piga argue that people strive for knowledge, to explore new things, and to set new goals, and not for a stagnant workless society. They remind us of Marshall's vision of the work of highly creative people, including entrepreneurs, being like a chase or competitive sport: "And so all the best business men want to get money, but many of them do not care about it much for its own sake; they want it chiefly as the most convincing proof to themselves and others that they have succeeded" (Marshall quoted in Pecchi and Piga, 2008).

Phelps (2008) provides a plausible micro foundation for the "employment Kuznets curve", the existence of which we speculated on earlier in this paper: "… He (Keynes) never saw that with the technical progress and capital deepening that he aptly postulates, an ever-increasing share of people can afford jobs that are stimulating and engaging. So unless the economic system is prevented from doing so, more and more jobs will be supplied that offer stimulation and engagement."

4. A TENTATIVE ASSESSMENT OF KEYNES'S PROPHECY

Summarizing his two main quantitative predictions, Keynes was right when in comes to growth, although he slightly underestimated the growth rates and average improvement in living standards. He was also right to predict a reduction in work time, but it seems he significantly overestimated its extent. Furthermore, it is not certain if this trend will continue, and the prospect of Keynes`s prophecy being fully met seems remote. After reviewing the opinions of more than a dozen first-rate economists, Pecchi and Piga are confident that it will never materialize, primarily because it is based on unrealistic assumptions of people`s behaviour, both as economic and social beings.

In this section we try to assess the validity and relevance of the main points of the criticisms briefly presented in the previous section. On closer inspection, some of them turn out to be of limited relevance once we abandon the 'strong' requirement that Keynes's prophecy should be fulfilled by 2030, and instead introduce the 'weak' proposition that at this point in time we already have enough indications that Keynes`s prophecy will eventually be fulfilled, without specifying the year or a century in which this will happen.

Increase in within-country and cross-country income and wealth inequality

Keynes did not neglect the issue of the level of income inequality remaining unchanged, but simply implicitly assumed that it would be so. "There will be ever larger and larger classes and groups of people from whom problems of economic necessity have been practically removed." Keynes did not specify if there is an 'objective' income threshold which is the same for everybody, or a 'subjective' threshold which varies depending on individual perceptions of the acceptable standard of living.

There are two questions relevant to our assessment: first, was he right to assume unchanged distribution, and second, if he was wrong, would that prevent the fulfilment of Keynes's prophecy in its 'weak' version? Regarding the first question, thus far he has been more or less correct for most 'progressive' countries. For over 50 years from 1930 within-country income inequality in most of these countries went down, and in the past quarter century it has gone up (Milanovic 2011), but typically not exceeding the initial levels of inequality. But even if, as is increasingly being claimed, growing wealth inequality further increases income inequality, this development might postpone, but should not prevent the realization of the 'weak' version of Keynes's prophecy, as long as the absolute standard of living of the majority improves. This would only not be the case in the most extreme situation of near-perfect concentration of capital, which is practically impossible in modern, especially democratic, societies.

When it comes to cross-country inequality the story is somewhat reversed, but is not fundamentally different from within-country inequality. Population-weighted between-country income inequality grew somewhat until the 1980s, and then started to decline thanks to unprecedented growth in China, the most populous country in the world, and, more recently, India, the second most populous country. It should also be noted that, strictly speaking, Keynes's prophecy is restricted to developed countries and does not require that the entire world population live in relative abundance and work a 15-hour week.

Ever-growing absolute and relative needs

The apparent insatiability of human need and the ability of technological progress to cater for it are probably the most important factors in the failure of the 'strong' version of Keynes`s prophecy. The sheer range of innovations leading to new and exciting products that transform everyday life, the spread of personalized services, the means of mass communication, the huge expansion of travel and tourism – these are all things that Keynes could not predict.

But most newly created products and services, like the old ones, are self-limiting because they cannot be fully consumed and properly enjoyed in additional time. Just as at the physiological level there is a limited daily amount of calories the body can burn, so there is a limited amount of time that can be devoted to and thus limited amount of sensations that can be experienced from all these great new possibilities of consumption. Today the average Western consumer is already overweight and over-harried. There are certainly possibilities for further intensification of consumption, but they are not limitless.

True, there is also an extensive as well as intensive possibility. Since the Industrial Revolution there has been an almost uninterrupted increase in life expectancy and longevity, which does not seem to stop. Thus, own consumption is being extended in time. However, according to most demographic forecasts, this extension of life will slow down and within several centuries will eventually stop.

Of course, there are symbolic ways to achieve immortality and to justify the insatiability of one's needs. Apart from catering for their own needs, most people want to secure a comfortable existence for their children, and often for further generations beyond.

However, a growing body of sociological, psychological, and economic research on quality of life, subjective well-being, and happiness typically finds that there is a certain threshold, no matter how high it might be, beyond which additional units of income do not make people happier. Within countries, richer people are on average happier and more satisfied with life than the poor. However, empirical inter-country comparisons (admittedly not entirely uncontroversial) show that for countries with income sufficient to meet basic needs the average reported level of happiness does not vary much with national income per person (Easterlin 1974).

Work as joy and challenge – to a degree

Keynes has been criticized for taking a dismissive attitude toward work, neglecting its many positive functions apart from subsistence and reducing it almost to atavism, by claiming that 15 hours of work per week is enough “to satisfy an old Adam in most of us”. But the question that interests us here is whether Keynes`s weak forecast is threatened because people will always want to perform market-based work for more than 15 hours a week. If this question is fair, the answer is self-evident. While it is true that a growing number of people find pleasure in their jobs, it is reasonable to assume that the majority would trade a 50% reduction in working time for double the wages, and engage in creative activities outside the labour market.

5. BROADENING THE CONTEXT – THE GREAT ESCAPE FROM POVERTY, HUNGER, DISEASE, AND BURDENSOME WORK

Focusing on GDP growth and income inequality controversies has detracted us from addressing Keynes’s prophecy within the more general context of human well-being and development. Since the engine of growth started to operate, progress in this area has been as spectacular as the increase in income but apparently less unequal and more widely shared. This is especially true of developed countries during the 20th century, but also to a very large degree of the rest of the world.

There are two exciting recent complementary narratives connecting GDP growth and improvement in the human condition, one emphasizing the role of improved nutrition (Fogel 2004), the other the role of public health (Deaton 2013). According to Fogel, the escape from hunger and premature death was the escape from a nutritional trap where people could not work to produce food because they were too weak, and they were too weak because they could not work to produce food to make them strong. This vicious circle has fortunately been broken, and a long ascent of humankind to what Deaton calls “Mount Waaler” has begun, a steady interconnected increase in height, weight, and longevity. As a result, people of today are much wealthier, healthier, taller, and heavier than ever before in human history.

This process has not been entirely uninterrupted, but its trend is still much smoother than the trend in income. In the 20th century, life expectancy has increased every year by three months on average, the increase in average height still being its best predictor. There are some notable exceptions: in Sub-Saharan Africa the spread of AIDS has wiped out the life expectancy gains of many decades. But in most countries the process of getting bigger and stronger is ongoing. At the end of the 18th century in Britain the average height of a 14-year-old working-class child was 1.3m, while an upper class child was "significantly taller" at 1.55m (Floud et al 2011). Today, as health services, nutrition, sanitation, and education have become universal, upper-class children have continued to grow taller, but at a slower rate than their working-class peers.

In a strange aberration, however, the United States, the tallest country of the world at the end of World War II, stopped growing almost two decades ago. According to Deaton, while Americans are not expanding upwards they continue to expand outwards, and the average American has passed the threshold of the weight that would minimize mortality risk. Consequently, life expectancy in the U.S increases at a much slower pace than in most European countries. An indirect explanation could perhaps be found in an intriguing little study of Granados and Roux (2009), who found that life expectancy increased during the Great Depression by as much as 6.2 years. The authors suggest that when people are working extra hard during good economic times, they experience more stress, exposure to pollution, and increased likelihood of injury as well as other longevity-limiting factors.

6. CONCLUSION

In accordance with Keynes`s optimistic prediction, the great escape from poverty, hunger, disease, and burdensome work is well underway. Beneath the worrying indicators of growing income inequality are more encouraging signs of convergence in things that really matter, things which are crucial preconditions for individual happiness and self-realization – longevity, health, education, availability of information. At some point the great escape from hunger and disease will be near completion: estimates are that within a century or two life expectancy might stabilize in the range from 90 to around 110 years. Similarly, the ascent to Mount Waaler will have to be completed, and the growth of the human race upwards - and certainly outwards – will slow down and eventually stop. What will remain is the limitless direction that Keynes suggested – the inward direction.

REFERENCES

Baumol, W. (2008), "Really Thinking Long Run: Keynes's Other Masterpiece". in Pecchi, L., & Piga, G. *Revisiting Keynes: Economic possibilities for our grandchildren*, MIT Press.

Chang, H. J. (2010), *23 things they don't tell you about capitalism*. Bloomsbury Publishing USA.

Club of Rome (1972), *The Limits to growth; a report for the Club of Rome's project on the predicament of mankind.*

Deaton, A. (2013), *The great escape: Health, wealth, and the origins of inequality*, Princeton University Press.

Easterlin, R. (1974), "Does Economic Growth Improve the Human Lot? Some Empirical

Evidence", in Paul A. David and Melvin W. Reder, (eds.), *Nations and Households in Economic Growth: Essays in Honor of Moses Abramovitz*, New York: Academic Press.

Floud, R. et al. (2011), *The Changing Body. Health, Nutrition and Human Development in the Western World since 1700,* Cambridge University Press.

Fogel, R. (2004), *The Escape from Hunger and Premature Death, 1700–2100: Europe, America, and the Third World*, New York: Cambridge University Press, 2004.

Freeman, R. (2008), "Why do we work more than Keynes expected?" in L. Pecchi and G. Piga (eds.) *Revisiting Keynes: Economic Possibilities for our Grandchildren*, MIT Press.

Galbraith, J. K. and Crook, A. (1958), *The Affluent Society* (Vol. 534), Boston: Houghton Mifflin.

Granados, J. A. T., & Roux, A. V. D. (2009), "Life and death during the Great Depression", in *Proceedings of the National Academy of Sciences*, *106* (41).

Keynes, J. M. (1931), "Economic possibilities for our grandchildren", in *Essays in persuasion*.

Linder, S. B. (1970), *The harried leisure class*, New York: Columbia University Press.

Milanovic, B. (2011), *The Haves and the Have-Nots: A Brief and Idiosyncratic History of Global Inequality,* Basic Books, New York.

Ohanian, L. E. (2008), "Back to the Future with Keynes", in *Federal Reserve Bank of Minneapolis Quarterly Review*, *32*(1), 10-16.

Pecchi, L. and Piga, G, eds. (2008), *Revisiting Keynes: Economic possibilities for our grandchildren*. The MIT Press.

Phelps, E. S. (2008), "Corporatism and Keynes: His Philosophy of Growth", in Pecchi L., Piga G., *Revisiting Keynes: Economic Possibilities for our Grandchildren*, MIT Press.

Skidelsky, R and Skidelsky, E. (2013), *How Much is Enough? Money and the Good Life*, Penguin Books.

Solow, R. (2008), "Whose grandchildren?" in Pecchi, L., & Piga, G. 2008. *Revisiting Keynes: Economic possibilities for our grandchildren*, MIT Press.

Solow, R. M. (1956), "A contribution to the theory of economic growth", in *The Quarterly Journal of Economics.*

Stiglitz, J. (2008), "Toward a general theory of consumerism: Reflections on Keynes's Economic possibilities for our grandchildren", in L. Pecchi & G. Piga (eds.), *Revisiting Keynes: Economic possibilities for our grandchildren*, MIT Press.

Swan, T. W. (1956), "Economic growth and capital accumulation", in *Economic record*, *32*(2).

Zilliboti, F. (2007), *Economic Possibilities for Our Grandchildren 75 Years after: A Global Perspective.* Working Paper, Institute for Empirical Research in Economics, University of Zurich.

Part II

Chapter 10

The Political Economy of the Cooperative Movement Before and After the First World War

Will Bartlett*
E-mail: w.j.bartlett@lse.ac.uk

Abstract: This paper analyses the political economy of the cooperative movement that developed in many European countries before, during and after the First World War as a form of countervailing power to the prevailing capitalist economic system. It was mainly organised among peasant farmers to defend supply prices through marketing cooperatives and credit unions; it also emerged among the growing urban populations in the form of consumer cooperatives to ensure a supply of quality goods at affordable prices and to a lesser extent through workers' production cooperatives. By 1914, cooperatives had emerged as a significant economic force in the Austro-Hungarian Empire, Imperial Russia, Italy, Germany, France and the United Kingdom. During the war, cooperatives provided a defense against poverty, and filled the gap in supply created by the inability of the private sector to supply of basic commodities as part of the war economy. Following the end of the war, cooperatives enjoyed a further development throughout the 1920s playing a significant role in post-war reconstruction. Associations of cooperatives became powerful economic actors and even began to develop as a political force. In 1927, the Russian economist A. Chayanov produced a significant theoretical analysis of the cooperative economy that countered the prevalent views of both soviet and pro-capitalist economists. However, with the onset of authoritarian rule in the 1930s, the cooperative movement lost ground. In Soviet Russia, collectivization of agriculture destroyed the peasant cooperatives, in Italy the cooperatives were suppressed by the Fascist state and in Germany and Austria by the Nazis. As a "third way" between the inequalities of capitalism and the overbearing central control of the state under Stalinism and Nazism the cooperatives had demonstrated their economic viability and resilience in the face of economic crises and the ups and downs of the business cycle. However, in the period after the Second World War they played little role in Keynesian mixed economies, in centrally planned Soviet communism, or in Titoist "self-managed" socialism in Yugoslavia. Only Italy and France have today retained significant cooperative movements. Recent interest in the "social economy" has brought attention back to the role of cooperatives as a rational form of economic organisation capable of prospering in a market economy. The experience of the cooperative movement before and after the First World War should therefore act as a reminder of the relevance of this form of economic organisation as an important element of an appropriate response to the economic crisis that afflicts Europe today.

Key Words: Cooperatives; Credit Unions; Chayanov

JEL Classification: B31, B52, N00, P13, P16, P26, Q13

* European Institute, London School of Economics and Political Science

1. INTRODUCTION

Cooperative enterprises differ from conventional enterprises in a number of key respects. The main difference is that the organisation is responsible to stakeholders other than those who supply the capital input of the enterprise. The assignment of ownership rights in a firm has implications for the costs of contracting and the costs of ownership. As Hansmann (1988, 2012) has shown, an efficient economic organisation is one that minimizes the sum of both of these costs. In different industries and market conditions the sum of these costs will be minimized by assigning ownership and control rights to different groups of patrons, be they suppliers of capital, suppliers of labour, or customers. Firms owned by the suppliers of capital are typically capitalist or investor owned firms that operate essentially as investor cooperatives with decision-making proportion to the amount of shares held by each capital owner, thus placing rights to residual earnings with those most willing to bear risk in markets with high levels of uncertainty. Firms owned by suppliers of labour are employee-owned firms or producer cooperatives, minimizing the risk of contracting in markets with high risk of employment fluctuations. Firms owned by consumers are typically credit or consumer cooperatives, minimizing contracting costs by placing ownership with those who have better information about credit worthiness of customers in the former case or may benefit from monopsony power in the latter case. Firms owned by their suppliers are typically agricultural marketing cooperatives, interested in the reduction of contracting costs on the market by increasing their monopsony power. The ownership assignment in each case solves problems of asymmetric information, potential opportunism, or benefits of market power to the patron who has the greatest gain from a reduction in the costs of contracting with other patrons given that the costs of ownership are not too great. The latter factor includes costs of monitoring effort of factor owners, which often requires homogeneity of interests or abilities among the respective ownership group. As we will see below, this is often the case for agricultural marketing cooperatives in which farmers live in the same geographical region and grow the same crops, or in credit cooperatives of the so-called Raiffeisen type in which the cooperating savers live in a small village and share interests and customs.

Decision-making powers in a cooperative are usually based on the individual voting rights attached to membership within the cooperative rather than on the share of capital contributed (although the later can be considered to be investor cooperatives). The economics of cooperative enterprise has been extensively debated and discussed (Bartlett and Uvalić, 1986). Producer cooperatives may enjoy enhanced productivity due to increased motivation attached to membership of a cooperative rather than subordinate employee status in a conventional firm (Bonin et al. 1993)[1]. Marketing cooperatives may offer the benefits of monopsony power and higher market prices than isolated relation to the market to their members. Consumer cooperatives may also enjoy monopsony power leading to lower prices of their purchases than would be available to private purchases on the market. The economic theory of cooperatives also points to some disadvantages. Producer cooperatives may suffer from under-investment especially where assets are held in common rather than on an individual basis. Cooperatives may also suffer from free-rider problems as each member bears a small proportion of the costs of under-supply of effort (Holmstrom, 1982).

Today, cooperative enterprises within Europe are found mainly in France, Italy and Spain, while there are relatively few examples of cooperatives in Central and South Eastern Europe (Bartlett and Pridham, 1991). Yet, before WWI, the cooperative movement had developed to a significant extent in these countries as a form of countervailing power to the prevailing capitalist economic system.

Consumer cooperatives were mainly organised by peasant farmers to defend supply prices through marketing cooperatives and they also emerged among the growing urban populations in the form of consumer cooperatives to ensure a supply of quality goods at affordable prices. Credit and marketing cooperatives were also important before WWI. The great growth and spread of the cooperative movement among farmers from the 1870s to the 1890s on can also be lined to the experience of the so-called "Long Recession, which lasted from 1873 to 1896 and involved a steady deflation of agricultural prices. Producer cooperatives also emerged at this time as a means of creating and defending employment among workers, although they were developed to a lesser extent than credit and marketing cooperatives.

During WW1 the cooperative movement received a significant boost in many countries as the need for regular supplies for both the civilian and the military economies could not be met by the private capitalist sector alone, which proved unable to increase production on the basis of private profit incentives due to the enormous uncertainty created by wartime conditions. Alongside an increase in the state control over production, the cooperative movement in all its forms (credit, marketing, producer) made a significant contribution to filling the gaps left by the ineffective private sector.

Following the end of the war, cooperatives enjoyed a further development throughout the 1920s, through Europe including in South East Europe. Associations of cooperatives became powerful economic actors and even began to develop as a political force. As a "third way" between the inequalities of capitalism and the

---

1 Empirical evidence on the relevance of these theoretical hypotheses is scarce but increasing with a growth of empirical evidence especially related to producer cooperatives. Studies of matched samples of cooperatives and private firms in Italy have shown higher productivity among cooperatives (Bartlett et al., 1992), greater investment in workforce skills (Bartlett, 1994) and more stable employment (Pencavel et al. 2006). Similarly, cooperatives in Uruguay have been shown to have greater employment stability during cyclical downturns more than capitalist firms (Burdin and Dean, 2009).

overbearing central control of the state under Stalinism and Nazism the cooperatives demonstrated their economic viability and resilience in the face of economic crises and the ups and downs of the business cycle. However, they played little role in Keynesian mixed economies, in centrally planned Soviet communism, or in Titoist "self-managed" socialism in Yugoslavia. Only Italy and France retained significant cooperative movements.

Recent interest in the "social economy" has brought attention back to the role of cooperatives as a rational form of economic organisation capable of prospering in a market economy. The rest of the paper presents a review of the development of the cooperative movement in various European countries before during and after the First World War, with a focus on Austria-Hungary, Germany, Italy, Russia and Serbia. The concluding section summarises the findings and lessons learned for contemporary policy maker from this often forgotten phase of European economic history.

2. COOPERATIVES BEFORE AND AFTER THE FIRST WORLD WAR

The first cooperative was established in 1844 in Rochdale, England, as a consumer cooperative by a group of labourers who aimed to provide goods for themselves and their families at lower prices than on the open market. This experience was emulated throughout Europe. Other forms of cooperatives were developed including marketing cooperatives and credit cooperatives. In some countries, producer cooperatives were also established to provide employment for the cooperative members. By 1914, cooperatives had emerged as a significant economic force in the Austro-Hungarian Empire, Imperial Russia, Italy, Germany, France and the United Kingdom. During the war, cooperatives provided some defense against poverty, but were undermined by the encroachment of the state into the supply of basic commodities as part of the war economy. Following the end of the war, cooperatives enjoyed a renaissance throughout the 1920s, also in South East Europe. Associations of cooperatives became powerful economic actors and even began to develop as a political force.

Table 1 shows the number of cooperatives of different types by country at the time of the First World War. It can be seen that in terms of absolute numbers, the cooperative movement was especially important in Austria-Hungary, France, Imperial Germany, Imperial Russia and Switzerland. Credit cooperatives saw their greatest development in Austria-Hungary, Imperial Germany and Imperial Russia, having been first developed in Germany. Agricultural marketing cooperatives were strong in Denmark as well as Austria-Hungary, France, Imperial Germany, Imperial Russia and Switzerland. Consumer cooperatives were overall largest in number and geographical scope and were strongly developed in Austria-Hungary, Denmark, France, Imperial Germany, Imperial Russia, Italy, Netherlands, Switzerland and the United Kingdom. Worker (producer) cooperatives were less developed than most other forms, with the largest numbers in Austria-Hungary, Imperial Germany, Italy and Imperial Russia.

Table 1: Number of Cooperatives by Type By Country

	Year	Credit	Insurance	Agricultural	Workers	Consumers	Other	Total
Austria	1915	12,380	—	3,548	1,286	1,433	649	19,296
Belgium	1908	629	66	808	221	400	213	2,337
Denmark	1915	13	—	3.047	—	1,562	—	4,622
Finland	1914	512	—	798	45	517	428	2,300
France	1911	3,946	—	8,706	497	2,951	—	16,100
Germany	1918	19,703	—	8,048	1.029	2,277	5,137	36,284
Greece	1918	—	—	830	—	—	97	917
Hungary	1916	2,609	800	667	—	1,915	81	6,072
Italy	1919	(a)	—	425	2,351	3,814	425	7,015
Netherlands	1917	796	64	909	18	1,065	531	3,383
Russia	1919	26,500	—	8,500	5,000	40,000	—	80,000
Spain	1918	—	—	24	—	218	—	242
Switzerland	1918	444	750	5,281	107	1,706	2,298	10,586
United Kingdom	1918	(a)	—	(a)	95	1,364	15	1,474

Source: Parket (1920) p. 153. Note: (a) Not reported

Credit cooperatives were formed under two main types. The first type was the Schulze-Delitsch credit cooperative. Schulze-Delitsch credit cooperatives were based on individual ownership rights in which each member held shares. The credit cooperative operated as a bank, taking loans and issuing loans in proportion to a member's shareholding. The Schulze-Delitsch credit cooperatives were organised as limited liability companies[2].

The second main type of credit cooperative was the Raiffeisen credit cooperative. These were designed as unlimited liability organisations that did not rely on member shareholding (Peal, 1988). The feature of unlimited liability made the repayment of each borrowers loan an important aim for all members of the cooperative, who were expected to exert social and moral pressure on potential defaulters. An indivisible reserve fund was established as the main capital of the Raiffeisen credit cooperative. Loans were distributed on the guarantee of at least two other members of the cooperative. Loans are only made to members of the cooperative, normally for a relatively short period to encourage regular repayments. The main basis of the cooperative was one of mutual trust and so the cooperatives were

2 Franz Hermann Schulze-Delitzsch (29 August 1808 – 29 April 1883) was a German economist who organised the first credit union.

by design small-scale organisations that were based on inter-personal knowledge within a local community. The first Raiffeisen credit cooperative was established in Germany in 1864. They were soon transferred to many others countries, usually but not always successfully[3]. This type of credit cooperative resembles the Grameen bank style of micro-credit banks popularized in recent years as a tool of economic development throughout the world.

2.1 Cooperatives in Austria Hungary

The first Austrian cooperative, a Schulze-Delitzsch credit society, was established at Klagenfurt in 1851. The cooperative movement spread throughout the Austro-Hungarian Empire. Legislation regulating the formation and management of cooperatives was passed in 1875 and again in 1898, which legalized business organisations operated by and for the members (Kirschbaum, 1980). Raiffeisen style credit cooperatives were established among farmers and the Austrian Raiffeisen Union was established in 1898. A federation of agricultural cooperatives was formed the same year and a consumer federation in 1901. This network of cooperatives grew vigorously in many corners of the empire in the years leading up to World War I. A national federation of cooperatives was established in 1872. In Austria the credit cooperatives were highly developed. By 1915, there were more than twelve thousand such organisations (see Table 1).

The first cooperative in Hungary was a credit association established at Beogterce in 1850. The first cooperative legislation was passed in 1875. Count Alexander Karolyi established a cooperative federation for consumer cooperatives, "*Hangya*", in 1898. A federation of credit cooperatives was established at the same time (*Orszagos Kozponti Hitelszovetkezet*).

The development of cooperatives in Slovakia began shortly after the creation of the Rochdale cooperative in England, and may have been an independent development. A local schoolteacher called Samuel Jurkovič established the first "farmers' society" in the village of Sobotiste "to protect poor people against the greed of unscrupulous swindlers" (Kirschbaum, 1980: 32). The system of agricultural cooperatives spread throughout Slovakia in subsequent years including dairy cooperatives, farm-supply cooperatives, cooperative grocery stores, flour mill cooperatives, warehouse cooperatives, rural electric cooperatives, forest cooperatives, fruit and wine cooperatives and others (Kirschbaum, 1980). A Central Cooperative for marketing cooperatives was established in 1912. By the end of the Austro-Hungarian Empire in 1918, there were 1,146 cooperatives in Slovakia of which 262 were credit unions (mostly of the Schulze-Delitzsch type) and 595 consumers' cooperatives. After the

[3] The transfer of this model of credit cooperatives to Ireland under the guidance of Henry Plunkett was one of the few examples of failure, due to the unwillingness of Irish rural communities to enforce repayment and the lack of development of regional level of the cooperatives to transfer resources from surplus to deficit cooperatives (Guinnane, 1994).

end of WWI, the cooperative movement in Czechoslovakia developed strongly. By 1936 there were 2,543 cooperatives of various types with around 400,000 members.

In Croatia, the Croatian-Slavonian Agricultural Society was established in 1847 to teach better agricultural production methods (Coffey, 1922). It turned itself into a marketing cooperative in 1911. A Union of Serbian Rural Banks was formed in 1897, and by 1909 it had 2,097 organisational members, mainly credit cooperatives of the Raiffeisen type, which between them had 10,031 individual members. The Serbian Union was regarded with extreme distrust by the Hungarian government and was closed down. The Serbian Union was re-established at the end of the war and by 1920 had 400 member cooperatives and 26,000 individual members. A Croatian Agricultural Union was established in the early 1990s out of the Agrarian Bank, which was founded in 1901. By 1914 the Croatian Union had 293 organisational members and more than 35,000 individual members. The Croatian Union was mainly composed of credit cooperatives but also had marketing cooperatives among its membership. During WW1 the membership of the Croatian Union stagnated and no development took place. The movement began to grow again once the war was over within the new State of Serbs, Croats and Slovenes. A new Union of Croatian Rural Cooperative Societies was established as a separate organisation from the Agrarian Bank. In 1922, the new Union had 313 member societies and 42,449 individual members. Taking the Croatian and Serbian Unions together it can be seen that in the early 1920s the cooperative movement in Croatia had nearly 70,000 members.

In addition to credit societies, a variety of different types of cooperatives were established in Croatia. Coffey (1922) describes a cattle breeding cooperative at St Ivan Zabno which specialised in raising Simmenthal cattle imported from Baden in Germany, an agricultural procurement cooperative in Karlovac, a combined credit cooperative and consumer cooperative in Bukovec, and dairy cooperative at Ricica that was founded as a credit cooperative in 1911 but developed a cooperative dairy during WWI in response to the collapse in imported butter products from Denmark.

2.2 Germany

Cooperatives developed in Germany as a response to the disorganization of rural community life brought about by the emergence of capitalist economy in Germany in the mid-nineteenth century. The main form of cooperative development in Germany was the credit cooperative. This took two forms, as explained above: the Schulze-Delitsch type and the Raiffeisen type. Raiffeisen credit cooperatives were centred on the local community or parish. To increase the resource base, central cooperatives at a higher level were founded. After the early Raiffeisen banks were formed in the 1860s, a central bank was established at national level in 1874. This was transformed into a joint-stock bank in 1876 whose owners were the parish cooperatives.

The Raiffeisen cooperative movement grew throughout the 1870s during the period of the "Long Depression" (1873-1896)[4]. By 1888 there were 423 credit cooperatives of the Raiffeisen type (Peal, 1988). The movement developed rapidly thereafter. By 1910 there were 14,500 Raiffeisen type credit cooperatives in Germany (Hollis and Sweetman, 1998) and by 1918 there were 19,703 (see Table 1). In 1907, the loans provided by the Raiffeisen credit cooperatives accounted for 4.5% of all outstanding loans in Germany (Hollis and Sweetman, 1988: 1882). Borrowers were able to obtain loans at rates well below those charged by local private moneylenders. Many loans were made to the poorest people in the community to assist the purchase of agricultural inputs such as manure and feedstuffs, purchasing livestock, draining fields and sinking wells, in effect providing what is now called "microcredit" (Hollis and Sweetman, 1998). The rapid growth in credit cooperatives was partly due to the unsatisfied demand for credit from the peasant farmers, in the villages, but also due to the support from the state governments in the form of subsidies to support the rural populations that were suffering difficult economic conditions, partly due to the scarcity of credit. In 1889, a law was passed to ease the entry of new cooperative banks with limited liability manly aimed at the Schulze-Delitzsch cooperatives by regularizing their registration, entry and management, but which also benefited the Raiffeisen cooperatives (Peal, 1988).

A system of agricultural marketing cooperatives was developed by Wilhelm Haas, based on unlimited liability and which specialised in commodity trade through cooperative purchasing and marketing of agricultural products (Peal, 1988).

Cooperatives developed particularly strongly in Bavaria (Farr, 2007). Credit cooperatives predominated, but marketing and consumer cooperatives had a role to play as well. Dairy cooperatives were highly developed, with 8,123 farms belonging to milk cooperatives by 1895. By 1890 there are 344 steam-threshing cooperatives in Bavaria with 5,636 members. Cattle breeding cooperatives also developed in Bavaria at this time. As Farr points out "the collective purchase of seed, fertiliser, machinery and other farm requirements could place peasants in a much more advantageous position in the market…purchasing cooperatives could employ skilled buyers and the exploit the potential for large discounts on bulk orders…cooperatives could secure for their participants cheaper freight costs and a more even quality" (Farr, 2007: 175). From the mid-1890s the cooperative sale of agricultural products in Bavaria increased year by year.

[4] The Long Recession hit Great Britain especially hard and has been dated there from 1873-1896.

2.3 Cooperatives in Italy

The cooperative movement took off in Italy with the establishment of a consumer cooperative in Turin in 1854, and in 1856 a group of glassmakers in Altare, Liguria, formed the first Italian producer cooperative (Earle, 1986). Several other produced cooperatives were formed in the 1850s and 1860s. By 1870, there were 878 consumer and producer cooperatives in Italy. In Italy, Schulze-Delitsch credit cooperatives were established under the name of *banche populari*. By 1893 there were 730 such banche populari throughout Italy (Earle, 1986: 15). The banche populari were criticised as not being genuine cooperatives as they favoured the wealthier members of the community who could provide the largest share contributions. In 1876 a survey showed that most of the members of such banks were "small industrialists" while only 7.25% were day labourers (Earle, 1986: 15). Credit cooperatives of the Raiffeisen type were introduced in Italy by Leone Wollemborg who established the first such organisation, which became known as *casse rurali* in Lorregia, near Padua, in 1883. The cooperative had 32 founder members and increased its membership to 99 in the following year. A federation of casse rurali was established in 1888 and their numbers had reached 143 by 1894.

An important feature of the Italian cooperative movement was the establishment of various national cooperative federations. The most important of these was linked to the Socialist Party and was called the *Lega Nazionale* while the second most important federation was *Confederazione Nazionale delle Cooperative*, which brought together cooperatives established by the Catholic Church.

In 1902, the total number of cooperatives in Italy reached 2,299 with 567,000 members, and by 1910 the number had grown to 5,056 cooperatives with 1.1 million members. In 1910, the cooperatives were given increased access to public contracts. During the war, the cooperatives supported the war effort, providing uniforms and light equipment for the armed forces (Earle, 1986: 18). The *Lega Nazionale* collaborated with the government in the distribution of food and other supplies for the armed forces and the civilian population. By the end of WWI the cooperatives emerged in an even stronger position than they had been in before the war began. At the end of 1918, the *Lega Nazionale* counted 2,321 cooperatives as members, while the *Confederazione* had 7,950 member cooperatives. The movement expanded further in the years immediately after the war; representatives from more than 8,000 cooperatives attended the 1922 conference of the *Lega Nazionale*.

The Fascist movement under Benito Mussolini was strongly opposed to the socialist cooperatives of the Lega Nazionale, and from 1920 onwards began to launch attacks against the cooperatives. Between January and June 1921 198 cooperatives in the Po Valley area alone were attacked by Fascist *squadristi* (Earle, 1986: 25). After Mussolini seized power in 1922, officers of cooperatives who refused to collaborate with the new regime were forced to resign. In January 1924, the government issued a decree to bring all cooperatives under the supervision of the provincial authorities. The Lega Nazionale, whose membership had shrunk to just 600, was dissolved in 1925 on the grounds of subversion. The cooperatives were not all dissolved, and the remaining cooperatives were absorbed into a new federation established by the Fascist government. The Lega Nazionale was eventually recreated in 1945, and remains a strong cooperative movement to this day.

2.4 Cooperatives in Russia

In Russia, the cooperative movement began to develop after the emancipation of the serfs in 1863. It was mainly developed among the peasantry, who initially worked land rented from the local authorities. Due to the high demand for credit to establish their farms, a main focus of cooperation was on credit cooperatives. Marketing cooperatives also began to develop for the sale of farm products as well as the purchase of agricultural implements and household articles. Consumer cooperatives also developed strongly both in the countryside and in urban areas and have been seen as progressive organisations under a conservative regime (Salzman, 1982). The spread of the cooperatives was initially limited by restrictive legislation and most were under state supervision until the revolution of 1905. The beginnings of limited constitutional government provided a stimulus to the formation of new cooperatives, whose numbers increased rapidly over the subsequent nine years.

Table 2: Number of cooperatives in Russia by type (1905-1918)

Types of cooperatives	1905	1914	1915	1918
Credit cooperatives	1,430	13,000	14,500	16,500
Consumer societies	950	10,080	11,000	25,000
Agricultural societies	700	4,680	5,000	6,000
Agricultural associations	0	1.250	1,800	2,400
Producer associations	2,000	3,000	3,300	4,500

Source: Kayden and Antsiferov, 1929: 14

The cooperative movement in Russia continued to develop during WWI. The growth of consumer cooperatives was stimulated by the difficult conditions facing the population during the war and the breakdown of the private system of food distribution (Salzman, 1982), while the growth of the producer cooperatives was stimulated by the demand from the State for supplies from the agricultural sector including military supplies such as food, uniforms and boots. According to one account "there was hardly a village over the vast territories of Russia and Siberia which did not possess a cooperative society" (Kayden and Antsiferov, 1929: 17). By 1917, there were 16,500 credit cooperatives and 25,000 consumer cooperatives (see Table 2)[5]. About one third of the entire population belonged to the credit or consumer cooperatives. It should be noted that a strong cooperative movement also developed in Ukraine, both in the eastern part with its centre in Kiev and supported by the economist Tugan-Baranovsky, and in the western part centred around Galicia which was part of the Austro-Hungarian Empire (Dillon, 1999).

The Moscow People's Bank was established in 1912 to serve the cooperative movement. The shares of the bank were owned by its member cooperatives, which elected the members of the board of directors. The bank financed the consumer cooperatives and enabled them to buy products at wholesale prices (Zelenko, 1920).

When the provisional government came to power in 1917, one of the first measures adopted was to pass a law establishing a new Cooperative Code. According to Kayden and Antsiferov "at one bold stroke the new legislation swept away the old custom of petition, official sanction, and special authorization" (Kayden and Antsiferov, 1929: 24). The new law applied universally to all forms of cooperation and provided for full freedom of internal self-government and management. It established that cooperatives were voluntary associations of individuals to promote their material and moral welfare by through collective organisation. The law provided for the creation of a reserve fund through annual deduction from profits of 20%, and limited the dividend on shares to 8% in the case of shareholding cooperatives with limited liability. The shares in such cooperatives were non-tradable. Cooperatives formed with collective capital had unlimited liability but only in relation to the profits set aside for the reserve funds and not the founding capital of the cooperative. Management of cooperatives was to be organised through the general meetings of the members or by the elected board of directors.

A national federation of consumer cooperatives was established in 1917, called the *Centrosoyus*. It was a founded as a continuation of the Moscow Union of Consumers' Societies[6], which had by that time spread across the whole country. Founded in 1898, the Moscow Union was started with a capital of 800 rubles with the purpose of performing wholesale trade for its affiliated members. By 1914 it has a membership of 1,243 cooperatives representing 426,968 individual members (Kayden and Antsiferov, 1929: 198). By 1917 it had 3,036 affiliated consumer cooperative societies. The Moscow Union soon branched out into the business of producing the goods that it supplied to its member cooperative societies. It also sold the products outside the Union members its production of manufactured goods increased at a more rapid rate than the sales to its members. One of its largest production activities was a boot factory on Zaraisk that employed 1,200 people, in addition to operating a fleet or 14 steamers, and 112 barges on the river Volga.

This organisation, along with the federation of consumer cooperatives from Siberia, the *Zakupsbyt*, opened offices in London in 1917 in order to promote trade

[5] Salzman (1982) gives a figure of 35,000 consumer cooperatives in Russia in 1917.

[6] Moskovskii Soiuz Potrebitel'nykh Obshchestv – MSPO.

with the English Wholesale Cooperative Society. In 1919 the *Centrosoyus* imported $6 million of goods and exported $3.5 million, mostly to England. Following the nationalization of the Centrosoyus in Russia, the managers of the London branch incorporated the business as "Centrosoyus Ltd." with a share capital of £250,000 in contradiction to the will of the new management in Moscow. However, the rebellion was brought to an end when the International Cooperative Congress in Basle recognised the Moscow based organisation in Moscow as the legitimate body, and the old directors abroad handed over the business to the new management. It was not long before nationalisation and the strategy of "war communism" was abandoned; the New Economic Policy (NEP) was introduced under the leadership of Bukharin, which again allowed the cooperatives to flourish (Cohen, 1980).

In the 1920s, the Russian economist Alexander Chayanov developed the concept of vertical cooperation, which referred to the forms of agricultural marketing cooperation that developed in Russia and elsewhere before the WWI based upon mutual associations and market relations that opposed the exploitation of the peasantry by monopsonistic purchasers of agricultural products. Chayanov was a leading thinker on the development of peasant agricultural economies, the Director of the prestigious Institute of Rural Studies in Moscow. In his book on "*The Theory of Peasant Co-operatives*" (Chayanov 1927, 1991) he promoted the idea of agricultural co-operatives as a form of vertical integration in agriculture. Under this system, which he observed emerging more or less spontaneously in Russia before the period of collectivization, co-operatives are formed by groups of peasant farmers for engage in large-scale marketing, purchasing, and the organization of credit. The basic idea (in contrast to the principal of horizontal integration through collectivization), was that agricultural activities in a peasant economy are best organized on small privately owned farms which provide strong incentives for individual effort, but that voluntary cooperation between such units can benefit from the economies of scale, and especially from the monopsony power of the marketing cooperative as a large purchasing organisation. In the words of one analyst "Chayanov supported a multi-level cooperative movement, a cooperative of cooperatives, organised from below and facilitated but not managed by the government" that would be based upon the "many thousands of cooperatives for supply, selling, credit and production [that] incorporated by 1928 over half od the Soviet rural population" and which challenged the alternative disastrous Soviet route of agricultural collectivisation that was to be adopted in the 1930s (Shanin, 2009: 89). When Stalin introduced this change in policy, Chayanov was dismissed from the directorship of the Institute of Social Sciences in 1930 and arrested for high treason and the sabotage of Russian agriculture (Shanin, 2009). Sent into exile, he was re-arrested in 1937 and executed.

2.5 Cooperatives in Serbia

The first cooperative in Serbia was founded in 1894; by 1910 there were 908 co-operatives, of which 615 were credit cooperatives, 43 distributive cooperatives, 153 machinery cooperatives, 12 dairies and 3 wine cooperatives (Coffee, 1922). By 1914, the number of cooperatives in Serbia had increased to 1,200. The cooperatives also had their own bank with its headquarters in Belgrade[7]. In addition to receiving deposits and making loans, the not-for-profit bank supplied seeds, fertilisers and agricultural machinery. The bank received an interest free loan from the state amounting to two million dinars.

During the war, the cooperative movement in Serbia was brought to a "complete standstill" (Coffee, 1922). The invading Austrian army caused great destruction among the cooperatives. One example can be gleaned from Coffey's 1922 investigation of the state of the cooperative movement in Yugoslavia. The largest wine cooperative in the country was begun in Selo-Banka, near Koracica in 1903, founded by 19 members. By 1911 it had about 100 members. Each member took one share of 50 dinars for every thousand vines he owned, and the Cooperative Union in Belgrade lent the cooperative two dinars for every dinar of share capital subscribed. It took four years for the cooperative to erect its buildings and start making wine. The cooperative bought grapes from the members at the market price, and paid a bonus to the members from the profits made from the sale of wine in proportion to the quantity of grapes supplied. A condition of membership was that all of a member's grapes would be sold to the cooperative. Members were also required to keep their vineyards in order, subject to inspection by officers of the cooperative. About a third of the farmers in district were members of the cooperative. During the war, the Austrian Army seized the cooperative's buildings, along with 6,000 kilos of old wine, 132,000 kilos of new wine and 2,000 kilos of brandy. Although they continued to operate the facility they did so on a private and not a cooperative basis. The wine cooperative at Smederevo suffered even more damage, as it was the scene of heavy fighting.

Another example is that of an agricultural cooperative in Markovec, which was prosperous enough to have constructed a two-storey building before the war. It had been founded in 1902 by 25 members each of whom held a 10-dinar share. The cooperative sold sugar, salt, coffee and oil and other commodities. By 1906 the cooperative had accumulated a profit of 30,000 dinars of 10,000 was spent on constructing the mentioned building. By 1915 the membership had increased to 300.

[7] The Belgrade Cooperative Bank is situated in Karadjordjeva Street in Belgrade. Founded in 1882, its members were small and medium traders, artisans and clerks. The president of the Cooperative was Luka Ćelović, a wealthy merchant, landlord and financier. He was the president of the cooperative until his death in the 1929, when his entire property was bequeathed to the University of Belgrade (source: Wikipedia)

However, the invading Austrian army seized all the assets and destroyed the books of the cooperative, and the cooperative did not begin to function again until 1920.

By the end of the war, only 600 of the Serbian cooperatives survived, but the movement was revived and grew rapidly. According to Coffee (1922), the context of the post-war economy was quite different to that before the war. As prices of agricultural goods increased rapidly, the credit cooperatives took in more deposits than they gave out in loans. The need was now not for credit cooperatives but for supply cooperatives, due to the greatly restricted supply of manufactured goods (Coffee, 1922).

One aim of the cooperatives was to change the terms of trade for the producers of agricultural commodities. For example, before the war the wine cooperative in Smederevo had 35 members whose liability was limited to ten times their shareholding. The price the cooperative was able to pay its members for grapes exceeded the market price by a considerable margin:

Table 3: Prices paid for grapes per 100 kilos at the Smederevo cooperative

	Market price (dinars)	Society's price (dinars)
1911	23.10	23.50
1912	23.55	35.97
1913	32.70	53.69
1914	40.77	62.80

Source: Coffee (1922) p. 16

In addition to the commercial activities of the cooperatives, as elsewhere the cooperatives also had a social function. The consumer cooperative at Merkovec referred to above also had before WW1 a reading room and library, that was intended to contribute improve the literacy of the local population. The cooperative building also functioned as a social centre and as a medical centre with a doctor employed by the cooperative to hold a clinic twice a week for the cooperative's members.

2.6 Cooperatives in other countries

In Bulgaria, the development of cooperatives was influenced by the experience of the German Raiffeisen credit cooperatives, the French production cooperatives and the British consumer cooperatives. The first credit society was established in 1863. The period from 1890 to the end of the century saw the establishment of the first agricultural credit cooperative (Oralo, at Mìrkovo, now part of Sofia), the first consumer cooperative, and the first production society (Rabotnik). A wine producers' cooperative, a cooperative bakery, and a sericulture cooperative were soon started and were quickly emulated. By 1918 there were 994 cooperatives and six national and regional unions had been organized.

3. CONCLUSION

This paper has analysed the development of the cooperative movement in several European countries before, during and after the First World War as a form of countervailing power to the prevailing capitalist economic system. It was mainly organised among peasant farmers to defend supply prices through marketing cooperatives and overcome credit rationing through the creation of different types of credit cooperatives. It also emerged among the growing urban populations in the form of consumer cooperatives to ensure a supply of quality goods at affordable prices and to a lesser extent through workers' production cooperatives. By 1914, cooperatives had emerged as a significant economic force in the Austro-Hungarian Empire, Imperial Germany, Imperial Russia, Italy, Serbia and elsewhere.

During the war, cooperatives provided a defense against poverty, and filled the gap in supply created by the inability of the private sector to supply of basic commodities as part of the war economy. Following the end of the war, cooperatives enjoyed a further development throughout the 1920s playing a significant role in post-war reconstruction. Associations of cooperatives became powerful economic actors and even began to develop as a political force. With the onset of authoritarian rule in the 1930s, the cooperative movement lost ground. In Soviet Russia, collectivization of agriculture destroyed the peasant cooperatives, in Italy the cooperatives were suppressed by the Fascist state and in Germany and Austria by the Nazis.

As a "third way" between the inequalities of capitalism and the overbearing central control of the state under Stalinism and Nazism the cooperatives had demonstrated their economic viability and resilience in the face of economic crises and the ups and downs of the business cycle. However, in the period after the Second World War they played little role in Keynesian mixed economies, in centrally planned Soviet communism, or in Titoist "self-managed" socialism in Yugoslavia. Only Italy and France retained significant cooperative movements.

Recent interest in the "social economy" has brought attention back to the role of different types of cooperatives as a rational form of economic organisation capable of prospering in a market economy. Modern development in the economic theory of organisations and contracts has revealed the underlying rationality of the cooperative form, confirming the insights of the Russian economist Alexander Chayanov in his studies of cooperative enterprise in Imperial Russia and the early Soviet Union. This paper's analysis of the experience of the cooperative movement before, during and immediately after the First World War should therefore serve as a reminder of the relevance of this form of economic organisation as an important element of the policy response to the economic crisis that afflicts Europe today.

REFERENCES

Bartlett, W. (1994) "Employment in small firms: are cooperatives different? Evidence from Southern Europe" in: J. Atkinson and D. Storey (eds.) *Employment, Small Firms and the Labour Market*, London: Routledge, pp. 256-87

Bartlett, W., Cable, J., Estrin, S., Jones, D. and Smith, C. (1992) "Labor-managed cooperatives and private firms in North-Central Italy: an empirical comparison", *Industrial and Labor Relations Review*, 46(1): 103-18

Bartlett, W., and Pridham, G. (1991) "Cooperative enterprises in Italy, Portugal and Spain: history, development and prospects", *Journal of Interdisciplinary Economics*, 4: 33-59

Bartlett, W. and Uvalić, M. (1986) "Labour-managed firms, employee participation and profit-sharing: theoretical perspectives and European experience", Special Issue of *Management Bibliographies & Reviews*, 12(4)

Burdin, G. and Dean, A. (2009) "New evidence on wages and employment in worker cooperatives compared to capitalist firms", *Journal of Comparative Economics*, 37: 517-533

Chayanov, A. (1991) *The Theory of Peasant Co-operatives*, (trans. David Wedgewood Benn) London: I.B.Taurus (first published in 1927 as *Osnovnye idei i formy organizatsii sel'skokhozyaistvennoi kooperatsii*)

Coffee, D. (1922) *The Cooperative Movement in Jugoslavia, Rumania and North Italy During and After the War*, [Carnegie Endowment for International Pace, Division of Economics and History, Preliminary Economic Studies of the War], New York: Oxford University Press

Cohen, S. (1980) *Bukharin and the Bolshevik Revolution: a Political Biography*, Oxford: OUP

Dillon, A. (1999) "The forgotten movement: cooperatives and cooperative networks in Ukraine and Imperial Russia", *Harvard Ukrainian Studies*, 23(1): 129-143

Farr, I. (2007) "Farmers' cooperatives in Bavaria, 1880-1914: 'State-Help' and 'Self-Help' in Imperial Germany", *Rural History*, 18(2): 163-182.

Guinnane, T. (1994) "A failed institutional transplant: Raiffeisen credit cooperatives in Ireland 1894-1914", *Explorations in Economic History*, 31(1): 38-61.

Hansmann, H. (1988) "Ownership of the firm", *Journal of Law and Organization*, 4(2): 267-304

Hansmann, H. (2012) "Ownership and organisational form", in: R. Gibbons and J. Roberts (eds.) *The Handbook of Organisational Economics*, Princeton NJ: Princeton University Press pp. 891-917

Hollis, A. and Sweetman, A. (1998) "Microcredit: what can we learn from the past?", *World Development*, 26(10): 1875-1891

Holmstrom, B. (1982) "Moral hazard in teams", *Bell Journal of Economics*, 13(2): 324-340

Kayden, E. M. and Antsiferov, A.N. (1929) *The Cooperative Movement in Russia During the War*, New Haven: Yale University Press

Kirschbaum, J.M. (1980) "The cooperative movement in Slovakia, 1845-1948", in: A. Balawyder (ed.), *Cooperative Movements in Eastern Europe*, London: Macmillan, 23-48

Navarra, C. (2013) "How do worker cooperatives stabilize employment? The role of profit reinvestment into locked assets", *WP 1307, Department of Economics Working Paper Series*, Université(Chayanov 1966) to perative Economy rtant area of the development of the cooperatives before WWI. examples in non-European cou de Namur

Parket, F. E. (1920) "Comparative study of the cooperative movement in various countries", *Monthly Labor Review*, October: 153- 166

Peal, D. (1988) “Self-help and the state: rural cooperatives in Imperial Germany”, *Central European History*, 21(3)

Pencavel, J., Pistaferri, L. and Schivardi, F. (2006) “Wages, employment and capital in capitalist and worker-owned firms”, *Industrial and Labor Relations Review*, 60(1): 23-44

Salzman, C. (1982) “Consumer cooperatives in Russia: goals versus gains, 1900-1918, *Cahiers du Monde russe et sovietique,* 23(3-4): 351-69

Shanin, T. (2009) “Chayanov’s treble death and tenuous resurrection: an essay about understanding, about roots of plausibility and about rural Russia”, *Journal of Peasant Studies*, 36(1): 83-101

Zelenko, A. J. (1920) “Russian cooperative movement”, *Monthly Labor Review*, June: 122-130.

Chapter 11

The Economic Development of Serbia Between the Great War and the Great Depression

Biljana Jovanović Gavrilović*
bgavrilo@ekof.bg.ac.rs

Gojko Rikalović**
rikgoj@ekof.bg.ac.rs

Dejan Molnar***
dejanmolnar@ekof.bg.ac.rs

Abstract: After World War I Serbia became a part of a large state, the Kingdom of Serbs, Croats, and Slovenes, which covered areas with different historical backgrounds and different economic development. This economic diversity was reflected in relatively developed market economies in Slovenia, Vojvodina, and parts of Croatia and a subsistence economy in certain areas of Serbia, Bosnia and Herzegovina, Macedonia, and Montenegro. The wider market, an abundant work force, diverse natural resources, and a favourable geographic position could have boosted economic development in certain parts of the country, including Serbia. However, Serbia's inherited problems, combined with the character of the established economic system, were unfavourable to formulating a strategy of general and regional development, and thus a more significant change in its economic position and structure.

As the Statistical Office of Serbia became a part of the centralized administration of the new state after World War I, statistical data are most frequently presented for the whole country and not for its constituent parts, based on which results for Serbia could be reconstructed. However, the statistical material that is available provides certain possibilities for analysis of individual areas. Starting from the available data, the paper will shed some light on the state of the Serbian economy immediately after the war, determine the available human and material production factors, and evaluate achieved results in economic development before the Great Depression, together with a review of key obstacles to economic development.

Key Words: Economic Development, Economic Structure, Factors Of Development, Development Limitations, Serbia.

JEL Classification: N140, O100

* Faculty of Economics, University of Belgrade. This work was produced as part of projects financed by Ministry of Education, Science and Technological Development, no. 179065 and III 46001.

** Faculty of Economics, University of Belgrade. This work was produced as part of projects financed by Ministry of Education, Science and Technological Development, no. 179065 and III 46001.

*** Faculty of Economics, University of Belgrade. This work was produced as part of the project financed by Ministry of Education, Science and Technological Development, no. 179065.

1. INTRODUCTION

During the 19th century, Europe recorded significant economic growth, which originated in the north western part of the continent (Britain, France, Germany, Belgium, the Netherlands), from where it spread to the south and east, gradually losing its strength. This development was uneven and relatively modest compared to modern standards. Even though in some less developed European economies such as Italy, Austria, and Russia, relatively dynamic economic progress was recorded at the end of the 19th and in the early 20th century, on the eve of the First World War almost all countries of Eastern and South-Eastern Europe lagged considerably behind compared to the northwest. Their per capita income averaged one half or less of that in the more developed parts of the European continent.[1] Besides Northwestern Europe, North America and Oceania were also drawn into the vortex of economic development and before 1913 had already exceeded the level of per capita income in the developed part of Europe. Even though they represented only 18% of the world population at that time, Northwestern Europe, North America, and Oceania were creating as much as 62% of the world income.[2] The development of non-European countries, especially the United States, challenged European supremacy. However, the pre-war world order was relatively stable: resources could be freely transferred between countries (primarily from the European periphery to the developed industrial centres in the northwestern parts of the continent) and there were no major differences in the economic progress of the industrialized economies.[3]

The First World War led to severe economic turbulence in both Europe and the world. By the end of the war the world as a whole was in a worse position than in 1913-1914, although some countries, such as the USA and Japan, were substantially exceeding pre-war production levels. Income and production fell in Europe, which emerged from the war with a much weaker economic performance and much worse position in the world economy. In 1920 its share in global trade was still below pre-war levels (49.2% versus 58.4%), while during the same period the share of the United States had increased significantly (from 22.4% to 32.1%). Svennilson estimated that if there had not been a war and if European industrial production had continued to grow at the average annual rate of 3.25% that had been recorded in the period 1881-1913, the level of industrial production in 1929 would have been reached eight years earlier, in 1921.[4] Hence it could be concluded that the war caused an eight-year delay in production growth.

---

1 Aldcroft (2001), p. 4.
2 Ibid, p. 5
3 Ibid.
4 See: *Europe After the First World War*, www.bates.edu/Prebuilt/Lecture_02.doc, [accessed 17th of July 2014], p. 3.

The population of Europe (excluding Russia) decreased by between 22 and 24 million (approximately 6.5 million military deaths and 5.5 million civilian deaths, while the remainder represents population loss due to reduced births), roughly 7% of the pre-war population. By 1920 Europe had roughly the same number of inhabitants as in 1914. Losses in equity were also significant. According to some calculations, 3-4 years of normal growth in income-yielding property were lost during the war. The total estimated expenditure for WWI was 6.5 times greater than the sum of all the national debt in the world accumulated between the late 18th century and the beginning of the First World War.[5]

In addition to general economic and other (political, social, psychological) consequences that the war produced in Europe, the specific position of individual countries affected by the war deserves attention. The focus of this work is the Serbian economy in the first decade after the Great War. We will explore the new economic and political reality in which Serbia found itself in 1918 and examine changes in the dynamics and the structure of production until the outbreak of the Great Depression.

2. A REVIEW OF THE STATE OF THE SERBIAN ECONOMY AFTER THE GREAT WAR

With the end the First World War the process of the unification of Serbia and other Yugoslav nations intensified, resulting in the formation of the Kingdom of Serbs, Croats, and Slovenes on 1st December 1918. The new national borders gave Serbia a surface area of 95,667 km^2 (Northern Serbia covered an area of 49,950 km^2 and South Serbia 45,717 km^2), or nearly two-fifths of the total Yugoslav state.[6]

The new country occupied an important strategic position in which the interests of the great powers crossed. This geo-economic area contained undeniable potential for development in its rich and diverse flora and fauna, hydropower, various mineral resources, forests, and extensive and cheap labour, but also inherent limitations in the fact that it represented a unique conglomerate. Populations with different histories, various state systems, different levels of economic (especially industrial) development, different agricultural regimes and ownership relations, different cultures, school systems, and religions, and as well as various political and economic aspirations were gathered in one country. In such diversity it was difficult to build the necessary economic institutions and to formulate an economic policy for development. For Serbia, the new government structure meant a larger market. Here we will agree with Bićanić that the new state created in Serbia "a sense of pride in the amount of things that the domestic market can be supplied

[5] Aldcroft (2001), p. 7-10.

[6] Isić (2007), p. 16.

with", especially since the Serbian people had paid such a high price for its formation on the battlefield.

In considering the economic situation in Serbia after the First World we refer to the book *Serbia in terms of wealth, before, during and after World War 1914-1918*. Serbia was a young country both politically and economically. After liberation from Ottoman rule its main focus was the political system and consolidating internal relations, not economic development or "the exploitation of natural soil resources and ...the development of its productive forces". Both then and later, statesmen and politicians were focused on political rather than economic issues. Serbia was not preoccupied with social problems and severe material differences, as was the case in older countries. Most people were engaged in agriculture and everyone, more or less, had a means of existence. Small peasant holdings were the basis of the population's well-being and maintained relatively healthy economic relations. More than three-quarters of the population was engaged in the production of raw materials. More than a quarter of the land was arable (corn, wheat, and other grains), and significant progress in modernizing production had been made in the last few decades. After arable crops came livestock, mostly cattle and pigs; then fruit growing - no Balkan state had such favourable conditions for growing as Serbia, and it produced many types such as plums, apples, pears, and cherries. Mining was also important: gold-bearing ore, mercury, lead, zinc, copper, iron, and coal were all mined in Serbia. Industrial production was mainly in the home and crafts; manufacturing was still in its infancy but there was a milling industry, meat processing, a textile industry, and a sugar industry, among others.[7]

The low level of industrial development is attested to by the fact that in 1918 there were 249 plants[8] in Serbia (in 1912 state borders) with a total of 29,069 employees, and 406 plants in Vojvodina (without Srem) with 27,622 workers.[9]

The First World War resulted in huge human casualties and material damage in Serbia, with a disastrous effect on its modest economy. Serbia lost around 28% of its population on the front, during the withdrawal of troops and civilians across Albania, and during the occupation (a total of 1,247,435, of which 370,000 were lost on the battlefield). To this should be added 114,000war invalids and 150,000 civilians with reduced working capacity. In some parts of Serbia population losses amounted to 50%.[10]

During the occupation the Serbian economy came almost to a standstill. The country was systematically looted. The enemy requisitioned human and animal food, took livestock, seized goods, money, and cars, confiscated production facilities

[7] See: Srpski Centralni Komitet (1918), p. 13-33.

[8] The term 'plant' is used in contemporary statistics to designate the part of an enterprise (company) which is an independent production unit and has production activity distinct from other parts of the company. See: Vukmirović (red.) (2008), p. 154.

[9] Ministsrstvo trgovine i industrije (1941), Belgrade, p. 67.

[10] Milenković (1998), p. 171.

and valuable works of art, and implemented damaging monetary and tax reforms. Records show that in the period from 1916 to 1918 agricultural production decreased by 70% and the agricultural inventory by 44%. Private industry lost 30% of its buildings and 57% of its equipment, and manufacturing lost half of its inventory. State production facilities were almost completely demolished and infrastructure was devastated. Damages to the railway decreased its value by 50%, and when the enemy withdrew the postal and telephone-telegraph services had been almost completely dismantled.[11]

After the war the economic situation in Serbia was very difficult. Agriculture was severely damaged and industry stagnant. The railway was mostly defunct, trade was reduced to local markets, and national banking was paralyzed.[12]

The Versailles Peace Treaty awarded Serbia and other victorious countries damages for losses suffered and sacrifices made in the war. According to an estimate presented in 1919 to the Allied Reparation Commission, Serbia's total damages amounted to around 6 billion gold francs, or 17 billion francs per post-war exchange rate.[13]

During the war Serbia lost more than half of its assets.[14] Under the circumstances, economic reconstruction and development were imperative. The task had to be solved in parallel with efforts to constitute and consolidate the new state. The political situation in the Kingdom of Serbs, Croats, and Slovenes was unsettled in the first post-war decade. Many governments fell, ministers changed, and Parliament was more preoccupied with politics than economic development, which was reflected in the results.

Analysis of Serbian economic development in the period 1918-1929 is dependent on the available statistical material. Although statistics progressed in that period, data were usually published for the whole country and not for the "historic areas" or districts and counties, from which, grouped together, it would be possible to determine Serbian territory. In 1929 Serbia became one of five duchies, of which only Moravska and Belgrade belong to present-day Serbia. However, even with the above limitations, the available statistical material provides a solid basis for analysis.

We will split the first decade of post-war development, the subject of our discussion, into two relatively distinct periods: the post-war period of reconstruction and accelerated investment, and the period of stabilization of the national currency and moderate growth until the global economic crisis.

11 Vučo (1968), p. 1-2.
12 Ibid, p. 4.
13 Ibid, p. 2.
14 Srpski Centralni Komitet (1918), p. 92.

3. THE DEVELOPMENT OF THE SERBIAN ECONOMY 1919-1923

Shortages of capital, raw materials, and skilled labour made the revival of the Serbian economy very difficult. The complex political situation in the country and the different visions of what its organization, constitution, and laws should be resulted in many delays (the Constitution was not passed until mid-1921). In the meantime the state was governed on the basis of temporary regulations. With a provisional state there was no designed, systematic policy to solve the accumulated economic problems; instead ad hoc measures and improvisations were applied.

The underdeveloped and devastated economy resulted in a rapid accumulation of capital. At first reparations significantly contributed to economic recovery, although they covered only a portion of the material damages that Serbia had suffered during the Great War. Only the citizens and various institutions, municipalities, counties, and districts of the Kingdom of Serbia and Montenegro were entitled to compensation from the reparations. The state disbursed the payments. A special regulation decreed that private individuals, companies, and associations should be paid first, with the rest going to the state to cover damages. In reality the state appropriated most of the reparations, often using them to finance the budget deficit. Apart was transferred to the owners of industrial and mining companies and to certain municipalities, while individuals had to be content with bonds for war damages that the state began issuing in 1922, with an interest rate of 2.5% and maturity of 50 years. The urban poor and the farmers who had suffered damages during the war sold the bonds below their real value in order to get cash, and the bonds soon became the subject of stock market speculation, resulting in huge profits for some individuals.[15]

In the period 1921-1931the Kingdom of Serbs, Croats, and Slovenes received around 666 million gold marks in reparations from Germany before the payments ceased, as Germany no longer had the money to pay them.[16] German debts could be paid in cash or in the form of goods (locomotives, cars, chemicals, agricultural machinery, coal, and livestock). In Serbia German reparations were used to partially reconstruct industry, but mainly they were spent on state infrastructure. Austria, Bulgaria, and Hungary were also unable to pay their war reparations due to unfavourable economic circumstances after the war.

In the early years, additional capital was provided through internal and external loans. In 1921 the government concluded an internal 7% investment loan to the amount of 500 million dinars, which was intended for the reconstruction and development of the transportation infrastructure, but was partially used to cover the budget deficit. In the absence of more extensive long-term investment funds,

[15] See: Vučo (1968), p. 8.

[16] Petranović (1988), p. 62.

the following year the foreign 8% of Blair's loan of 100 million dollars in American money market was obtained with a similar purpose. Less than half the total amount was acquired, and the part intended for the Belgrade-Adriatic Sea railway line construction was not realized. A second foreign loan was signed in 1923 with the French government to the amount of 300 million francs for the economic reconstruction of the country and equipping the army, but it also was not fully realized. Available capital was increased by obtaining foreign loans on behalf of the state banks, particularly the state mortgage bank.[17] In 1922 and 1923 this bank granted loans itself, primarily for the reconstruction of destroyed and damaged buildings, as well as for the construction of new housing.

The economic recovery of Serbia and the Kingdom as a whole complicated the unresolved issue of the currency. A variety of banknotes were in circulation in the new Serbia. Besides dinars (which replaced the occupational money in pre-war Serbia), Austrian crowns were present in large quantities (they were printed in Vienna and Budapest and flooded into the Kingdom of Serbs, Croats and Slovenes) and Montenegrin perpers, Bulgarian levs and German marks in much smaller quantities. In early 1919 the Kingdom of Serbs, Croats and Slovenes branded crown banknotes in order to limit their validity within the territory. Other countries that had belonged to the Austro-Hungarian Empire followed suit. In Serbia 421 million crowns were branded,[18]but poor technique resulted in the appearance of forgeries. Therefore, from the end of 1919 banknotes were marked with special stamps. Then the crowns were replaced by crown-dinar banknotes, issued by the National Bank, on which the value was printed in both crowns and dinars, with a ratio of 4:1. The Kingdom of Serbia's dinar was in circulation parallel with the new money and was exchanged 1:1. The crown was replaced first in the territory of the pre-war Kingdom of Serbia and Montenegro. By the end of 1921the currency had been completely unified. In1922 the crown-dinar notes were replaced with the new dinar banknote of the National Bank of the Kingdom of Serbs, Croats and Slovenes. The amount of dinars increased significantly in the process of replacing the crown, but the percentage of covered banknotes in the National Bank decreased, leading to weakening of the dinar and increased inflation.[19] The issuing of currency to cover the budget deficit, credit expansion, and constant foreign exchange deficit, which the devaluation of the dinar transmitted to the domestic market, increased already existing inflationary pressures.

An economic boom, based not on solid economic grounds but on excessive monetary emission and a weakened dinar, characterized the period from 1919 to 1923. From a low initial base the pace of development was rapid; war and destruction had resulted in vast unfulfilled needs, leading to the belief that everything con-

[17] See: Vučo (1968), p. 9-10.
[18] Becić (2003), p. 126.
[19] Milenković (1998), p. 177.

structed and produced could be sold. Liquidity was high and interest rates relatively low. Investment activity revived.

In the post-war conjuncture there was dynamic industrial development due to high customs protection and foreign capital input. Customs protection of industrial products was increased in 1921 in order to stimulate domestic industry. Previously (September 1920) companies had been allowed to import, duty free, complete industrial installations and machinery and other means of production and materials that were not produced in the Kingdom at all or in sufficient quantities. The need to obtain industrial equipment quickly and cheaply led to the importation of machinery that was obsolete in the exporting countries.

Customs duties on imports in undeveloped economies like the Kingdom of Serbs, Croats, and Slovenes, and within that Serbia, protect and promote both the domestic and the foreign capital in domestic industry, which can get a relatively high price for its products by using cheap labour and discarded industrial facilities. If the development of industry, even with foreign assistance, had been an imperative for the Kingdom and for Serbia, measures should have been taken to prohibit or restrict the importation of old machinery and to supply industry with modern means of production, to require that companies established with foreign capital should also use an adequate share of domestic capital, and to make the foreign companies train their local workforce to replace foreign experts (who were present in significant numbers and far better paid than local workers). This was the policy carried out in other countries that successfully managed their economic development and the welfare of the population.[20]

Concessions to foreign capital also contributed to the development of industry. Foreign capital dominated in the Bor ore mines, the metallurgical facility Trepča, the antimony mines in Zajača, etc. As a result the mining and ironworking industries in Serbia developed relatively fast, but other countries that used Serbia as a base for raw materials benefited most. Most of the production was exported in a raw or semi-processed state, processed elsewhere, and then imported back into Serbia. In 1923 mining and ironwork production in Serbia was worth 241.5 million dinars (in 1938 prices), mining production 139.5 million, and the ironwork industry 102 million.[21] The available data for 1919 are unrealistically low due to the great losses and delays in exploitation caused by the war, and so are of no use for comparison. Foreign capital was only involved in the production of goods for domestic consumption when it was able to achieve a monopoly position that guaranteed a substantial profit. The existence of monopolies resulted in high prices for many consumer products such as sugar, oil, and electricity, which had an adverse affect on the standard of living.

[20] Compare with: Mišić (1957), p. 290.

[21] Ibid, p. 275.

Thanks to the protection measures that were introduced, industry in Serbia was in a more favourable position than other economic activities. Consumer goods dominated industrial production. Most manufacturing consisted of semi-processed products and mining. There was very little production of equipment, which demonstrates the country's low level of industrial development and limited potential for future economic development. Funds needed for equipment were procured from abroad, and were used to reconstruct and expand existing plants, but also to equip new ones. Small businesses, not much different from craft workshops, dominated Serbian industry.

The number of newly built industrial plants testifies to the development of industry[22] in the period 1919-1923, which increased by 41% in Serbia (in the 1912 state borders) and by 24% in Vojvodina (without Srem). Over the same period the number of jobs grew by 31% and 25%, respectively (8,965 new jobs in Serbia and 6,799 in Vojvodina, a total of 15,764).[23] Therefore, over that period the number of plants and jobs increased more rapidly than the capital and available operating power, which means that small processing companies with poor technical equipment grew fastest. The technical backwardness of Serbian industry was caused by an abundant labour force, low wages, and the existence of monopolies, which disabled competition. The industries that developed after the war were food production (sugar, beer, chocolate, acetic acid), chemicals, wood and paper, textiles, non-metallic minerals, metals, and aerospace (two aircraft factories and one parachute factory were established in Serbia in 1923).

After the war the number of craft shops in Serbia grew rapidly, due to the high demand for products and services. A total of 12,184 permits to open craft workshops were issued between 1920 and 1923.[24] In the remote parts of Serbia handicrafts such as making shoes and blacksmithing were more developed, and in Belgrade and other major cities in Serbia there were new trades such as auto mechanics and, in construction, painting, decorating, plumbing, and electric installation etc. Small craft production that required little capital and few, if any, additional workers dominated. The 1910 Law on Shops favoured domestic producers, including artisan cooperatives and individual artisans, in procurements for the state, counties, districts, and municipalities[25]. The key obstacles to the development of handicrafts were industry competition and lack of working capital.

There was also progress in transport in Serbia during the period under review, both in terms of railway and road construction and technical resources. Important

---

[22] In the processing industry and some extractive industries, which were under the power of the Ministry of Trade and Industry. Mining and most ironworks are excluded from this statistic.

[23] Calculated based on data from: Ministarstvo trgovine i industrije (1941), p. 67. The number of jobs does not show the exact number of employees in the industry, but the maximum number of workers at full utilization of production capacity.

[24] Calculated based on data from: Milenković (2000), p. 19.

[25] Milenković (1998), p. 177.

communications such as the railways, the post, telegraph, and telephones were state-owned, as were the main roads such as those between Belgrade-Niš-Skoplje-Gevgelija and Subotica-Novi Sad-Belgrade. Serbian roads (including the main roads) were in poor condition. Transport development, particularly the railway, was largely due to military needs and not economic development, which was evident in the management of railways and railway construction[26]. The main Belgrade-Niš-Skopje railway was rebuilt with considerable effort in 1919. Regular communication between Belgrade and northern Serbia was established only at the end of that year when the Sava bridge was repaired.[27] In the railway sector, as in other sectors of the economy, private capital has always benefitted and the state suffered when there are business connections between the two. Although the river ports of Belgrade, Novi Sad, Senta, Bečej, Apatin, Šabac, and Smederevo were important, most of the piers were left unfinished.

In the early post-war years the development of trade took off, which was very attractive for investment, as evidenced by the relatively large number of retail shops. Trade growth was greatest in the cities, where the population grew rapidly. Initially, internal trade was under state control. So-called nutrition centres distributed food. At the beginning of 1919 a decree introduced free internal trade to facilitate the supply of groceries to endangered populations. This led to an expansion in speculative trade, i.e., the illegal sale of food products for profit in neighbouring countries (Hungary and Austria). In late 1919 a law on external free trade was introduced, but the abuse was not completely suppressed. A wide range of shops opened in Serbia, from pharmacies and hardware stores, jewellers and clock repair stores, to porcelain and glass shops and shipping services.

Up until 1923 the foreign trade balance was negative because of the importation of food and goods to reconstruct the destroyed economy, at a time when production in Serbia was significantly reduced and there were insufficient exports.

In the early post-war years agricultural development played a dominant role in the Serbian economy. According to 1921 data, over four-fifths (82.34%) of the population of North and South Serbia were engaged in agriculture[28]. Although it was the main economic activity, agriculture was backward due to mass illiteracy among the peasantry, lack of modern cropping practices, and traditional farming. According to the 1921 census, 65.5% of the population of Northern Serbia (i.e., within Serbia's pre-1912 borders) was illiterate; lower than in South Serbia (84%), but significantly higher than in Vojvodina (22.2%). Illiteracy was particularly high as it was largely a peasant society. In 1919-1920 around 59% of school-age children were enrolled in village schools in the fourteen districts of Serbia, and only

[26] See: Mirković (1968), p. 362.
[27] Milenković (1998), p. 174.
[28] Ibid, p. 24.

20% of the 77,216 students were girls (in urban schools the percentage of girls was about 41%)[29].

Favourable natural conditions enabled the development of all branches of agriculture, with crop production the most predominant. The small and medium-sized farms that prevailed in Serbia before and after the war mostly produced mixed crops and livestock for subsistence. The importance of farming increased in the post-war years due to the growing population and urban development, as well as the growing need for grain in the European market. The larger estates in Mačva, Posavina, and the Danube and Morava areas produced a surplus for the market[30], but elsewhere the yields per hectare were relatively modest. The yield of wheat, corn, and other grains was greatest in Vojvodina (without Srem).

Looting and the devastation of war had exacerbated the backwardness of the peasant agriculture. The occupiers destroyed or took much of the agricultural machinery. In the province of Serbia in 1919 there were only 312 wheat seeders, 501 hand threshing corn planters, and 1,724 corn seeders. The corresponding figures for Vojvodina (without Srem), with its larger farms and wealthier peasants where machinery of higher technical level was economically feasible, are 24,143, 1,200 and 12,605, respectively, and the disparity is obvious.[31] Small farms cultivated the land using primitive equipment, made by peasants or village blacksmiths.

The most important branch of agriculture in Serbia after arable farming was animal husbandry, which was also extensive. Pastures were used to feed livestock and the production of quality forage was ignored. The First World War particularly affected draught horses and cattle breeding. The 1921 livestock inventory shows Serbia with significantly fewer horses than before the war, and 50% less cattle per 100 inhabitants[32]. Low livestock numbers meant insufficient manure to maintain soil fertility and not enough raw materials of animal origin for industry (leather, wool, etc.).

In the early post-war years the state began a long and complicated process of agrarian reform and regulation of agrarian relations. Land now belonged to whoever farmed it, and previous owners were promised compensation. This agrarian reform was a means of calming social tensions: peasants from deprived areas who had fought in the Serbian and Montenegrin Army were awarded 3 to 5 hectares of land as a form of reward and recognition, in order to strengthen the border areas of Vojvodina and the former Kingdom of Serbia. It was also political, because the target of the reform was the large foreign-owned estates in Vojvodina and Srem, many owned by Germans. The reforms had a limited effect. The large estate owners protested publicly and behind the scenes, seeking support by creating division in government. The peasants received land but not the necessary means to cultivate

[29] Isić (1993), p. 96.
[30] Milenković (2000), p. 8-9.
[31] Becić (2003), p. 17.
[32] Vučo (1968), p. 23.

it and so failed to make it productive; many sold their new land to wealthy farmers at knockdown prices, or returned it to the previous owners.

The revival of economic activity in Serbia after the war was fuelled by a scarcity of food in Western Europe. Increased demand, especially for flour, wheat, maize, and meat, led to a transitory boom with high prices for agricultural products. The principal beneficiaries of the boom were the intermediaries: farmers sold their products at a much lower price than that reached on the stock exchange. Poor peasants suffered from the rise in prices, because they were not producing a surplus and had to supplement what they did produce by purchasing food. After the war, although farmers were to a certain extent freed from old debts, they accumulated new debts by purchasing land, livestock, and buildings, as well by purchasing food to maintain their families. Numerous small private banks were founded in the remote areas, which charged high interest rates on agricultural credit, especially during 1922 and 1923, but in this they were far surpassed by wealthy merchants and other local usurers[33]. In 1919 the government introduced export duties on agricultural and livestock products in order to secure cheaper supplies for the domestic market and to enlarge state revenues, which had a negative effect on Serbian agriculture. Export duties reached their peak in mid -1922 and gradually diminished after.[34] Export licenses were added to export duties and, along with ruined roads, obstructed the growth of exports, at the same time contributing to the spread of corruption among government officials. Both tariffs and bribes were passed on to the peasants, which resulted in the producers receiving lower prices. Thus redistribution of income was at the expense of farmers, reducing the positive effects of the post-war conjuncture.

4. SERBIAN ECONOMIC DEVELOPMENT IN THE PERIOD 1924-1929

The period from 1924 to 1929 is characterized by financial stability and moderate economic growth. The money supply, which had been expanding, was gradually brought under control. Scarcity of money pushed interest rates up. In order to balance the budget, tax and other government revenues were increased, and the number of government workers, which had grown significantly in the early war years, was reduced. There was a budget surplus in 1924/1925, albeit moderate, which continued in the following years. In 1925 the tax burden reached its peak, and in the following years certain taxes were reduced. This deflationary policy strengthened the dinar exchange rate and reduced prices in the domestic market.[35]

[33] See: Vučo (1968), p. 114. and Mirković (1968), p. 314.

[34] See: Vučo (1968), p. 110-111.

[35] See: Mijatović (2010).

The termination of monetary emission and strengthening of the dinar together with a balanced budget and high interest rates ended the post-war boom and showed the fragility of the foundations on which it rested. Industry declined, and many companies were forced to reduce production and fire workers. As factories and banks shut down, bankruptcy mounted. One reason for the decline of the post-war conjuncture was the end of reconstruction and the saturation of the market with particular types of products, as well as the declining purchasing power of workers and the worsening of the peasants' situation. Industrial production in developed countries had been largely restored and was technically improved, and strong protection measures made it very competitive and contributed to weakening industrial activity in Serbia. The decline in profits worried the big industrialists, who blamed the government's economic policies. The decline of industrial production after the post-war inflationary conjuncture was also marked by a significant reduction in stock exchange transactions of industrial company shares. In 1923 there were almost 1.2 billion dinars worth of transactions on the Belgrade Stock Exchange: the following year there were less than 380,000[36].

The following data testify to the changed circumstances: in 1924-1928 the amount of capital invested in Serbian manufacturing (within 1912state borders) was around a third (36.1%) less than in the previous five-year period, and in Vojvodina (without Srem) almost two-fifths less (38%). There was a modest growth in the number of industrial jobs, mainly in Vojvodina (without Srem). Between 1924 and 1929 there were 8,894 new manufacturing jobs in Serbia (within 1912 state borders) and 4,859 in Vojvodina (without Srem), a total of 13,753. For the total decade under review, 1919-1929, there were 29,517 new manufacturing jobs, an annual average of only 2,952.[37]

Serbian mining and ironworking increased in the period 1924-1929 (and later, despite the economic crisis). In 1929 mining was worth 333 million dinars (in 1938 prices) and ironworking 272 million, and the total number of employees in both industries was 17,606. By both indicators, production and employment, Serbia was the leading province in the country[38]. Ironworking developed faster than mining: the average annual growth rate of production increased by 16.3% in 1924 and by 14.5% in 1929 (1923 = 100)[39]. The production and partial processing of metal ores in Serbia were very important. The natural mineral wealth of Serbia began to be exploited, but unfavourably from the perspective of economic development, as the higher processing stages associated with foreign capital investment took place abroad, leaving Serbia at a low level of economic development. For example, in 1929 Bor mines, which were in French ownership, awarded their shareholders a 300% dividend; i.e., three times more than the nominal value of the share capital.

---

[36] See: Vučo (1968), p. 55- 56.

[37] Calculated based on the data by: Ministarstvo trgovine i industrije (1941), p. 67.

[38] Mišić (1957), p. 275.

[39] Calculated based on the data by: Mišić (1957), p. 275.

That year 440 million dinars worth of raw copper was exported and the total profit was half a billion. The price of its production was covered by just the value of the gold extracted from it, and the total value of the copper and part of the value of the gold went into the hands of the shareholders, i.e., became French financial capital. An average annual income of around 300 million dinars could have funded as many as 30 big factories in Serbia over 10 years, with investment capital of 100 million dinars for each one: but in fact none were built[40].

In the period 1924-1929 industrial development in Serbia decreased, but industry was in a better position than other economic activities. The 1925 General Customs Tariff, which was implemented by the government without the consent of parliament, further protected domestic industry, and until 1931 export duties ensured low prices of some domestic raw materials (wool, hair, bones, etc.) that were used in domestic industries. This was to the detriment of farmers and weakened the development of raw agricultural materials. There were other new measures of protection that favoured industrial production; for example, the 1925 tariff on railroad traffic favoured industrial products. The tariff was set so that it did not matter if raw materials were transported from 20 or 200 kilometres away[41], so industrial facilities were located without paying attention to where the raw materials were produced.

Post-war industrialization was accompanied by urbanization. Belgrade had 111,739 inhabitants in 1921 and 238,775 ten years later, an increase of 113.7%. It became the administrative and cultural centre of the new government, where political power was concentrated. The population of Novi Sad also increased rapidly in the decade under review, from 39,122 to 63,985, an increase of 63.6%[42]. There was dynamic population growth in towns such as Kragujevac and Zemun, and the latter changed from being a town on the periphery of Belgrade to practically becoming a part of the capital. Rapid post-war development expanded production facilities: in 1928 there were 676 industrial enterprises in the Belgrade area and 478 in Novi Sad[43]. Infrastructure was improved in the larger cities, modern buildings and cultural facilities were constructed, and the quality of life improved.

In the shadow of industry, crafts thrived, especially leather and textiles (shoemaking, tailoring). In 1924-1929 Serbia issued a total of 20,155 permits for craft shops, exceeding the yearly average for the previous period[44]. Income from crafts was very low, particularly for apprentices. To improve the situation a Craft bank was founded in 1927, with the state providing 40% of the share capital (30 million of a total of 75 million dinars). However, lending conditions for crafts were less fa-

[40] See: Mirković (1968), p. 338- 339. and Hanžeković (1968), p. 33.
[41] See: Mišić (1957), p. 280.
[42] Calculated based on the data by: Vukmirović (2008), p. 55.
[43] Petranović (1988), p. 68.
[44] Calculated based on the data by: Milenković (2000), p. 19.

vourable than for industry and agriculture.[45] Crafts were largely subordinate to the interests of industrial capital, and their development was limited by the purchasing power of consumers. The importance of craft cooperatives, which could have helped the problems faced by craftsmen, was not recognized in Serbia. In 1927 the covenant artisan crafts cooperatives had only 70 members (credit, supply, and processing cooperatives).[46] However, crafts retained an important place in the Serbian economy, which is partly explained by the insufficient development of industry.

In this period the development of transport lagged behind the needs of the economy. Building roads was a slow process despite the availability of domestic cement and asphalt and an abundance of labour. In 1929 two laws on the construction and maintenance of roads were passed, for the state and for self-governing areas (i.e., the duchies and municipalities). State roads were funded by motor vehicle taxes (cars, motorcycles, tractors) and in the self-governing areas by tax-payers' labour, paid and unpaid. That same year a law was passed exempting all shipping companies and river boat and tug shipyards from dues and taxes in order to spur the very modest technical progress of river transport. However, this only lead to increased profits for the company owners. The private transport sector made demands on the government, mainly related to the reduction of railway tariffs, but only when it was in their interest. Railway tariff decisions were made by the Commercial Section of the Ministry of Transport, advised by the tariff board, which principally comprised representatives of industry, mining, and crafts and in which the balance of power was more important than the real interests of economic development. The development of railway transport in Serbia is illustrated by data on railway freight traffic for 1929 (the last year of normal transport before the crisis) from the Central Train Directorate in Belgrade (covering Serbia and Macedonia). The total volume of 2,552.550 tons (of which the domestic market accounted for 2,286.205 tons, imports 140,181 tons, and exports 208,179 tons) was considerably lower than in the northwestern parts of the kingdom,[47] partly because a lot off reight in this part of the country was transported by water via Belgrade, as the largest river port, and partly because economic development, other than in Belgrade, was considerably lower than in the north west.

The restrictive monetary policy adversely affected the development of trade and decreased demand, primarily among the rural population, and businesses experienced problems selling accumulated stock. Many retail shops underwent liquidation or went bankrupt. In the area covered by the Belgrade Chamber of Commerce the reduced number of established retail outlets is particularly noticeable after 1926[48]. According to data covering the entire period from 1919 to 1929 in Serbia, a total of 38,294 licenses for shopping outlets were issued, of which one-quarter

[45] See: Mirković (1968), p. 356.
[46] Petranović, p. 75.
[47] Mirković (1968), p. 366.
[48] Vučo (1968), p. 121.

were in Belgrade.[49] The trading network gradually spread to cover villages and smaller towns, which contributed to better supply. Development of trade in the country benefitted from the impounding of peasant estates in the process of agrarian reform, which reduced the ability of the rural population to supply its needs from its own farms. A serious obstacle, however, was the decline in farmers' purchasing power, which became apparent between 1924 and 1929.

During the period under review there was a positive foreign trade balance, except in 1927 and 1928. Exports were predominantly primary products, while industrial products were imported, and so the country was exposed to unfavourable trade terms, which impeded its economic progress.

Developments in agriculture, as the key economic activity, made their mark on the economic development of Serbia in the period 1924-1929. Data for 1931 show that the share of agricultural in North and South Serbia declined by 0.34 percentage points per year.[50] From this we estimate the approximate share of agricultural in the total population in 1929 to be 79.64%. Between the 1921 and 1931 censuses there was some progress in literacy, as an important precondition of economic and overall social development. The illiteracy rate in Serbia (within 1912 state borders) decreased to 55.09%, while the average annual decline was 1.04 percentage points. Assuming an average pace of illiteracy reduction in previous years, the percentage of illiterate people in this area in 1929 was 57.17%. In Vojvodina 19.02% of the population was illiterate in 1931 and the average annual reduction of illiteracy since 1921 was 0.32 percentage points; thus the percentage illiterate in 1929 was 19.66%.[51] Belgrade, as the capital city, had the lowest illiteracy rate in Serbia, but this does not apply to Belgrade district, as the peasantry surrounding Belgrade was largely illiterate. A higher percentage of illiterate people in the country, especially among the female population, was characteristic of the whole of Serbia.

During the period 1924-1929 agrarian overpopulation became a problem due to significant population growth and the low absorption power of industry and other sectors of the economy. The solution was sought in wage labour and different forms of leases, such as working land for wages, for a share of the produce, for the payment of debt, etc. Agricultural wageworkers were most numerous in Vojvodina, as this province had already established agrarian capitalist relations. Most of them were landless and marginal farmers who were forced to work other people's estates in order to secure a living. Some farmers were entrepreneurs ('home industry'), and some of them looked for a solution in temporary or permanent internal migration. This brought peasants from Eastern Serbia to Šumadija, Slavonia, Bosnia, and larger cities such as Belgrade to search for work. The rural population also emigrated abroad, especially from the mid-twenties during the cyclical ascents in overseas

[49] Milenković (2000), p. 23.

[50] Milenković (2000), p. 24. Average annual decrease of agricultural share in total population during the period 1921-1931 is calculated based on the data given by the quoted source.

[51] Calculated based on the data by: Isić (1993), p. 97- 99.

economies.[52] Agrarian overpopulation contributed to the further fragmentation of properties, taking over forests and other less productive land, degrading livestock, and disrupting the balance between livestock and crop farming.[53] Overpopulation was a brake on agricultural productivity and improving technical equipment.

There are no exact data on changes in the technical level of agriculture during the period under review, but based on import statistics, which cover the whole country, it can be concluded that until the1930 world financial crisis there were some positive, albeit modest, shifts. Technical improvement of agricultural production was limited by the lack of cheap agricultural loans. The establishment of the Directorate for Agricultural Credit in 1925 was an attempt to solve this problem but failed due to lack of funds. The issue of cheap agricultural loans remained unresolved until the Privileged Agrarian Bank opened in 1929, when the world economic crisis was already growing.

After 1923 the situation of the peasants in Serbia worsened. Actions taken to stabilize the dinar in 1924 and 1925 and cheap agricultural products from overseas, which flooded the European market after 1925, decreased the price of agricultural products in the domestic market. The high tariff protection enjoyed by industry and the impact of world market prices on agriculture favoured the spread of 'price scissors' at the expense of agricultural products. At the same time the tax burden on farmers increased, which led to the tax insolvency of the rural masses. Floods and droughts during this period also contributed to the situation. Peasant debt rose sharply with the decline in prices of agricultural products. As the deflationary policy of the government contracted the credit markets there was even more borrowing at high interest rates. For a long time the state did nothing to help farmers. Measures were taken only when the problem had escalated to deepen the crisis in other sectors of the economy. In 1932 the Law on the Protection of Farmers was passed, and in 1936 the Regulation on the Liquidation of Agricultural Debt, which remembered the fact that Serbia had abolished Milos Obrenovic's institution of 1836, that which protected farmers from forced sales in order to pay debts. Referring to the right of small estate protection institutionalized between 1836 and 1873 in Serbia, Damaschke, at the end of the First World War, found a link between the military bravery of the Serbian people and the establishment of rights to protect small estates.[54]

[52] See: Vučo (1968), p. 43-61.

[53] Čobeljić (1980), p. 20.

[54] Damaschke, A. (1917), Die Bodenreform - Grundsätzliches und Geschichtliches zur Erkenntnis und Überwindung der sozialen Not, 14.unveränderte Aufl, p. 438, according to: Srpski Centralni Komitet (1918), p. 16.

5. CONCLUSION

In the first decade after the Great War, economic development in Serbia (and throughout the Kingdom of Serbs, Croats and Slovenes) was renewed and economic activity intensified. It was a more or less spontaneous process, which happened under difficult economic and political circumstances and in the absence of well designed, thorough, and organized action by the state. Economic policy was ad hoc, with no long-term plan or genuine commitment by government to improve the national economy and well-being of the population. The underdeveloped economy was left to the fluctuations of the world market and the interests of foreign capital and other forces, whose interest was preserving the existing, backward economic structure. Not even the post-war period of favourable economic conjuncture, with high prices for agricultural products, strong tariff protection, and inflow of foreign government and private loans, resulted in the expected effects on the economy of Serbia (and the country as a whole). With the agrarian crisis and drop in agricultural prices the weakness of the economy was evident. The economic development of Serbia in the period 1919-1929 was characterized by a strong social differentiation between a tiny class of rich capital-owners and public authorities, and the mass of workers and poor peasants.

For a synthetic overview of economic development in Serbia we use data on the movement of GDP/national income for the period under review. These data are available for the Kingdom of Serbs, Croats and Slovenes and not for Serbia, but can be used as a representative guide from which to draw conclusions. Relying on Maddison's data, the average annual growth rate of real gross domestic product in the period 1920-1929 was 4.4%. Growth of per capita GDP was considerably lower (2.9%) due to the relatively rapid increase in population. These growth rates, although they appear significant, were achieved from a very low starting base. In the same period Czechoslovakia recorded a growth rate of 5.8%, Austria 5.1%, France 4.8%, Germany 4.8%, Italy 2.9%, the UK 1.8%, and the USA 3.9%[55]. On the eve of the First World War, in 1913, Serbia's per capita GDP of $1,060 (in 1990 prices) was at its highest but was the lowest in Europe. In 1929 the newly enlarged Serbian state had a per capita GDP of $1,364, at the bottom of the European list except for Romania ($1,102) and Bulgaria ($1,128).[56]

National income, which is closely linked to economic development, was not calculated or analysed in the newly formed Kingdom of Serbs, Croats, and Slovenes until 1927.[57] Much later, Stajić calculated real (and nominal) national income for the period 1923-1939. From 1923 until 1929 the average annual economic growth rate was 3.9%, with industry growing faster than agriculture. This led to some

[55] Calculated based on the data by: Maddison, A. (1995), *Monitoring the World Economy 1820-1992*, OECD Development Centre, Paris, p. 148, 154 and 201, according to: Nikolić (2003), p. 52 and 236.

[56] Broadberry and Klein (2011), p. 20 and 24.

[57] Paper by: Đuričić, V. et al. (1927), *Naša narodna privreda i nacionalni prihod*, Sarajevo.

changes in the structure of the national income in favour of industry, although agriculture remained the dominant economic activity.[58] In Serbia the development of industry was relatively rapid. However, the development of the Serbian economy in the first decade of the post-war period did not solve the chronic problems of agriculture. The population was growing, and many agricultural workers were displaced, but industry could not absorb the surplus labour. In addition, the structure of industrial production was inadequate and was dominated by consumer goods.

In the first decade of post-war development in the Kingdom there was a foreign trade deficit in six years and a surplus in four years. Developed economies that rely on their own resources strive for a balance of export and import flows; this imbalance in the under-developed Kingdom of Serbs, Croats, and Slovenians indicates a lack of development and absence of borrowing from abroad to enhance scarce domestic capital.[59]

Despite certain results in economic development in the period 1919-1929, Serbia remained economically underdeveloped compared to Western European countries. The main aggravating factors that prevented progress were a lack of capital and skilled manpower, low level of technical equipment, dominance of small industrial production, general backwardness of agriculture, and significant reliance on foreign capital, which was largely speculative. In addition, Serbia was a peasant culture, with a high level of illiteracy.

The economic crisis that gripped the world in 1929 eventually transferred to Serbia. Development problems in the Serbian economy that became evident after the transient post-war conjuncture come to the fore in these new conditions.

REFERENCES

Aldcroft, D. H. (2001), *The European Economy 1914-2000*, Routledge, New York.

Becić, I. (2003), *Finansijska politika Kraljevine SHS 1918-1923*, Stubovi kulture, Beograd.

Broadberry, S. and Klein, A. (2011), "Aggregate and per capita GDP in Europe, 1870-2000: continental, regional and national data with changing", EuroGDP2.

Čobeljić, N. (1980), *Privreda Jugoslavije – rast, struktura i funkcionisanje*, knjiga prva, Savremena administracija, Beograd.

Europe After the First World War, www.bates.edu/Prebuilt/Lecture_02.doc, [accessed 17th of July 2014].

Hanžeković, M. (1968), *Privredni system Jugoslavije*, Narodne novine, Zagreb.

Isić, M. (2007), "Od Srbije do Srbije", in Isić et al. (ed.) (2007), *Srbi i Jugoslavija – država, društvo, politika*, Institut za noviju istoriju Srbije, Beograd, pp. 13-24.

Isić, M. (1993), "Pismenost u Srbiji u prvoj polovini XX veka", *Tokovi istorije*, br. 1-2, pp. 91-103.

Marsenić, D. (1990), *Ekonomika Jugoslavije*, Ekonomika, Beograd.

58 Stajić, S. (1959), *Nacionalni dohodak Jugoslavije 1923-1939. u stalnim i tekućim cenama*, Ekonomski institut, Beograd, prema: Nikolić (1992), p. 126.

59 Marsenić (1990), p. 175.

Mijatović, B. (2010), "Ekonomska politika i konjunktura u Jugoslaviji 1919-1925, *Radni documenti iz ekonomske istorije"*, Centar za liberalno-demokratske studije, Beograd.

Milenković, M. (2000), "Specifičnosti privrednog razvoja Srbije 1918-1929", *Tokovi istorije*, No. 3-4, pp. 7-26.

Milenković, M. (1998), "Obnavljanje privrednog života u Srbiji posle Prvog svetskog rata", *Tokovi istorije*, No. 1-4, pp. 171-178.

Ministarstvo trgovine i industrije (1941), *Statistika industrije Kraljevine Jugoslavije, sa adresarima industrijskih preduzeća,* Beograd.

Mirković, M. (1968), *Ekonomska historija Jugoslavije*, Informator, Zagreb.

Mišić, D. (1957), *Ekonomika industrije FNRJ*, Naučna knjiga, Beograd.

Nikolić, G. (2003), *Kurs dinara i devizna politika Kraljevine Jugoslavije 1918-41,* Stubovi kulture, Beograd.

Nikolić, M. (1992), "Economic Development of the First and Second Yugoslavia", *Yugoslav Survey*, Vol. XXXIII, No. 2, pp. 125-166.

Petranović, B. (1988), *Istorija Jugoslavije 1918-1988,* prva knjiga, Nolit, Beograd.

Srpski Centralni Komitet (1918), *Srbija u imovnom pogledu - pre, za vreme i posle svetskog rata 1914-1918,* Štamparija "Ujedinjenja", Ženeva.

Vukmirović, D. (red.) (2008), *Dva veka razvoja Srbije: statistički pregled*, Republički zavod za statistiku, Beograd.

Vučo, N. (1968), *Agrarna kriza u Jugoslaviji 1930-1934*, Prosveta, Beograd.

Chapter 12

Pyrrhic Victory: The Great War and its Immediate Consequences for Serbia's Economy

Miloš Jagodić*
E mail: mjagodic@f.bg.ac.rs

Ognjen Radonjić**
E mail: oradonji@f.bg.ac.rs

Abstract: The effects of World War I on the economies of European countries, both developed countries and those on the periphery, were devastating. Whether or not they were on the winning side, the war caused all countries involved to economically regress. Naturally, war ravages, and its destructive forces hit countries that turned into battlefields especially hard. Unfortunately, Serbia was one of them. The aim of this paper is to present the immediate consequences of the war on Serbia's economy. It focuses on Serbia's demographic losses and the impact of the war on Serbia's agriculture, industry, and state finances. It is based on official statistical data and the relevant literature.

Key Words: World War I, Demography, Agriculture, Industry, War Financing

JEL Classification: N14, N34, N44, N54, N64

1. INTRODUCTION

At the beginning of the 20th century, Europe was a dominant world economic power. It had a 46% share of the world's total gross domestic product (GDP) and a 41% share of the world's GDP per capita. The most important factors behind the rapid economic development and growth of the most developed European economies were the industrial revolution and the colonization of agricultural peripheral countries - economies of the 'Third World'. In the year that preceded the outbreak of WWI the proportion of workers employed in agriculture in Western Europe was around 28%, in Russia 70%, and in the Balkan countries more than 80%.The devel-

* Faculty of Philosophy, University of Belgrade. Research for the paper was funded by the Serbian Ministry of Education, Science and Technological Development (project no. 177014)

** Faculty of Philosophy, University of Belgrade. Research for the paper was funded by the Serbian Ministry of Education, Science and Technological Development (project no. 179035).

oped Western European economies were the world leaders in industrial production. In 1913 their share of world industrial production was 52% and of world trade 62%. The industrial production of the three most developed European economies, i.e., Germany, Great Britain, and France, represented 37.4% of the world's total industrial production, while their share in world imports of raw materials and food was 63%. (Berend 2006, pp. 20-22).

The Balkan countries remained outside the main development trends, mainly due to their historical heritage, a backward education system, and very limited production resources. In the Balkans 80% of the labour force on average worked in agriculture, and only 10% in industry. Any capital that these countries imported was mainly used for building a modern public administration, to supply the army, and for the construction of monumental buildings in the capital cities. In Serbia 40% of imported capital was used to cover military spending and the budget deficit (Berend 2006, p. 37). Consequently, it is not surprising that the economies of the Balkan countries significantly lagged behind the European core economic powers.[1]

No less important were the growing differences in the level and dynamics of development among Central European economies. At the beginning of the 20th century Great Britain, as the dominant world power, began to lag behind. The same was true for the Netherlands; whereas France managed somehow to maintain its economic strength. In parallel, Germany became the economic and technological leader of Europe. The epicentre of German industry was the coal industry, and iron and steel. In 1913 these three branches comprised around 18% of total German industrial production. Germany produced twice as much steel as Britain and three times more than France. The Germans also had highly developed electricity production and engineering and a highly developed chemical industry. Between 1897 and 1913 the growth of German GDP per capita increased by 32% and was the highest in Europe (Berend 2006, pp. 25-26). The increasing gap in economic development between the European powers and the merciless mutual competition and struggle in the race to conquer new territories led to an ever-growing hostility, which had its epilogue in what was then the largest and the bloodiest war in world history. The scale of the Great War's devastation and human catastrophe was inconceivable and incomprehensible.

The decline in the European birth rate and the loss of military and civilian lives (excluding those in Russia) resulted in a population deficit of 22 to 24 million people, with around 7 million permanently disabled (Berend 2006, p. 50). The estimated cost of the war was 80.68 billion US dollars, which was equal to 115.5% of the total national wealth of Great Britain (England, Scotland, Wales, and Ireland) in 1914 (Gnjatović 1991, pp. 110-119). The paradox of the Great War was that both the countries that gained territory and those that lost it needed decades to

[1] For example, the level of GDP per capita of Eastern European economies (9 countries) in 1913 equalled only 46% of the Western European average (23 countries). Maddison (1995), p. 228.

reconstruct and stabilize their new national economic systems. Thus, in the period between 1913 and 1919, the GDP of Austria declined by 38%, of Belgium by 20%, France 25%, and Germany 28%; while the GDP of Great Britain remained stagnant (Maddison 1995, pp. 180, 182). Naturally, the ravages of war and its destructive forces hit countries that had become battlefields especially hard. Sadly, one of these was Serbia.[2]

This paper deals with the immediate, short-term consequences of World War I on the Serbian economy. It is divided into four chapters, focusing on demography, agriculture, industry, and state finances respectively. The aim of the paper is to establish and present changes in the mentioned fields by comparing pre- and post-war data. Demographic loss was doubtless the most significant single consequence of the war, for the Kingdom of Serbia was predominantly an agricultural country with production based on human labour and livestock. Therefore absolute loss and estimated demographic loss are examined in detail in the paper. The chapter regarding agricultural production in Serbia focuses on the comparison of livestock numbers and variety before and after the war and on comparison of cultivated land areas in 1904 and 1921. Although modest before the Great War, industrial production in Serbia was virtually reduced to nothing in the first post-war year. The chapter regarding industrial production will show the vast scope of deindustrialization in Serbia as an imminent consequence of the war. The last chapter analyses state finances during the war through the continual accommodation in budget income and spending as well as changes in external debts to allied countries. The paper is based on official statistics and other publications and on the relevant domestic literature.

2. SERBIA IN THE VORTEX OF THE GREAT WAR

On August 10th 1913 a peace treaty was signed in Bucharest between Serbia, Montenegro, Greece, and Romania on the one side, and Bulgaria on the other. The Balkan Wars were over. The Balkan Peninsula was liberated from Ottoman rule by an alliance of Serbia, Montenegro, Greece, and Bulgaria in the First Balkan War (1912-1913). Bulgaria then attempted to resolve territorial disputes with its former allies by force and suffered a defeat in the Second Balkan War (1913). The Kingdom of Serbia emerged victorious from the wars, gaining significant territory (81.4% of its pre-war area), and its population increased by 50.9%. Although victory came at the price of 36,500 casualties and heavy material sacrifice, all strata of Serbia's society were optimistic after the Balkan Wars. The country faced the difficult task of integrating the newly acquired territories into its legal and social framework. Serbia's

[2] Besides France, Belgium, Poland, and Russia.

Prime Minister, Nikola Pašić, declared that integration would take thirty peaceful years (Jagodić 2013, pp. 21, 22, 113, 138).

However, less than a year later, the Sarajevo assassination was used as an excuse by Austria-Hungary to declare war on Serbia on July 28th 1914. Vienna considered that the time was right to effect its previously devised plan for a pre-emptive attack to annihilate Serbia as an independent country (Mitrović 1981, pp. 23-177). Exhausted by the recent wars, the Serbian Army was forced to defend the country against a much stronger enemy. Severe battles were fought in the autumn and winter of 1914, mainly in the north-western parts of Serbia (Podrinje, Valjevo, Rudnik, and Belgrade counties) and several major defeats were inflicted on the invading Austro-Hungarian forces. By the end of 1914 the enemy's troops were ousted from Serbian soil. However, there were many dead and the war regions were devastated. The first half of the following year passed without major military operations on the Serbian front, but a typhus epidemic decimated both civilian population and troops. In the autumn of 1915 a joint offensive of Austria-Hungary, Germany, and Bulgaria, which had entered the war on the Central Powers' side in October, was launched against Serbia. The country was simultaneously attacked from the north, west, and east. Serbian armies put up stiff resistance and retreated slowly under constant combat to the south, towards expected French and British reinforcements, which eventually failed to break through from the Thessaloniki bay along the Vardar valley. Thus all of Serbia was turned into a battlefield. The armies' retreat was followed by a mass exodus of refugees. In late November 1915 the Serbian High Command ordered a pullback to the Albanian Adriatic coast. The only remaining available routes went through the mountainous terrain of Montenegro and Albania. After an epic march that claimed many lives, remnants of the Serbian Army, along with the King, government, Members of Parliament, and many civilian refugees, reached the coast. They were later evacuated to Corfu by the Entente's warships. In the meantime, Austria-Hungary and Bulgaria divided Serbian territory into three occupational zones: one Austro-Hungarian (north-west Serbia) and two Bulgarian (north-east and south Serbia). Serbia, however, did not capitulate. Its army was reorganized and resupplied by the Entente at Corfu and then shipped to Thessaloniki to join British and French forces at the newly established Macedonian front. A breakthrough was achieved at the end of 1916 when Bitolj was retaken from the Bulgarians. Trench lines were then stabilized, approximately along the Serbian-Greek border. For a year and a half, until early autumn 1918, there was bitter combat, until finally the Central Powers' front was broken. An energetic and swift offensive of Serbian, French, and British troops ensued, forcing first Bulgaria and later Austria-Hungary to surrender. By the end of November 1918 Serbia was liberated and its armies marched on into Austro-Hungarian territory. On December 1st 1918 the unification of Serbs, Croats, and Slovenes into a single Kingdom was proclaimed in Belgrade (History of the Serbian People 1983, pp. 7-254). Unfortunately, from an economic perspective, this was a Pyrrhic victory, as it came at great cost.

3. DEMOGRAPHIC LOSSES

Population censuses relevant to our topic were conducted in 1911 (January 13th 1911)[3], 1913 (April 16th 1913)[4], and 1921 (January 31st 1921). The first comprised Serbia's territory before enlargement in the Balkan wars, the second comprised only areas annexed by Serbia in 1913, and the third comprised the whole Kingdom of Serbs, Croats, and Slovenes. However, the territories referred to as North Serbia (Serbia's pre-Balkan Wars territory) and South Serbia (regions annexed by Serbia in 1913)were slightly larger in 1921 than in 1911/1913. For comparability of 1911/1913 and 1921 census data, in this paper 'North Serbia' and 'South Serbia' will refer to the territory of the Kingdom of Serbia in 1911 and the territory annexed by Serbia in 1913, respectively. Therefore, a necessary subtraction of the population from the 1921 census is made.[5] The comparison between the 1911/1913 and 1921 censuses is presented in the following table (Table 1).

The data above clearly show a decrease in population in almost every administrative county, apart from Kumanovo and Bregalnica counties and the city of Belgrade. The significant increase in the latter's population can be explained by immigration. There is a noticeable population decrease in the counties where major battles were fought in 1914-1915 (Podrinje) and 1916-1918 (Bitolj and Tikveš).

However, Table 1 only indicates Serbia's loss of population, because the time frame (1911/1913-1921) is incompatible with the duration of WWI. Unfortunately, 1919 and 1920 data on fertility and mortality rates and migration are unavailable. On the other hand, there is a difference between absolute loss of population and

---

[3] The critical date for the census was December 31st 1910 according to the Julian calendar, i.e., January 13th 1911 according to the Gregorian calendar.

[4] This provisional census took place in February and March of 1913: it did not have a critical date and it was not conducted in accordance with the usual statistical regulations. It was taken by the local communal authorities, under the supervision of the army. We have decided to use April 16th 1913 as the critical date, for that was the date when the main report on census' results was written (Jagodić 2013, p. 116).

[5] The population of the following regions in North Serbia, ceded to Kingdom of Serbs, Croats, and Slovenes by Bulgaria according to the 1919 Treaty of Neuilly-sur-Seine, is subtracted from the 1921 census: communities Veliki Jasenovac, Šapikovo, Aleksandorvac, Braćikovac, and Crnomasnica attached to Krajina County, communities Gradskovo and Halovo attached to Timok County, Caribrod District and Zvonce community attached to Pirot County, and Bosilegrad District attached to Vranje County. The population of the following regions in South Serbia is subtracted from the 1921 census: Pljevlja, Bijelo Polje, Berane, and Metohija Counties (territories annexed to the Kingdom of Montenegro in 1913), District Has, ceded by Albania to the Kingdom of Serbs, Croats, and Slovenes and attached to the County of Prizren, and Strumica District, also ceded by Bulgaria in 1919 and attached to Tikveš County.

Table 1. Population of Serbia in 1910/1913 and 1921

County	Number of inhabitants		Difference in number of inhabitants between 1911/1913 and 1921	
	1911/1913	1921	number	%
Belgrade	155815	138920	-16895	-10.84
Valjevo	157648	133974	-23674	-15.02
Vranje	252937	230350	-22587	-8.93
Kragujevac	189025	165981	-23044	-12.19
Krajina	112142	99173	-12969	-11.56
Kruševac	167371	153014	-14357	-8.58
Morava	203638	184539	-19099	-9.38
Niš	198768	187270	-11498	-5.78
Pirot	112314	106833	-5481	-4.88
Podrinje	238275	182627	-55648	-23.35
Požarevac	259906	217998	-41908	-16.12
Rudnik	85340	76203	-9137	-10.71
Čačak	138911	121922	-16989	-12.23
Smederevo	143216	128043	-15173	-10.59
Timok	149538	132226	-17312	-11.58
Toplica	110218	107915	-2303	-2.09
Užice	146763	119424	-27339	-18.63
City of Belgrade	89876	111739	21863	24.33
North Serbia 1911	**2911701**	**2598151**	**-313550**	**-10.77**
Prijepolje	49315	42322	-6993	-14.18
Raška	81214	72365	-8849	-10.90
Zvečan	81643	70137	-11506	-14.09
Kosovo	193337	171285	-22052	-11.41
Prizren	124101	89404	-34697	-27.96
Tetovo	146803	117179	-29624	-20.18
Skoplje	157078	145880	-11198	-7.13
Kumanovo	144983	147184	2201	1.52
Tikveš	84657	59960	-24697	-29.17
Ohrid	84395	69211	-15184	-17.99
Bitolj	232646	180732	-51914	-22.31
Bregalnica	101442	104347	2905	2.86
South Serbia 1913	**1481614**	**1270006**	**-211608**	**-14.28**
Serbia Total	**4393315**	**3868157**	**-525158**	**-11.95**

Sources: Population and Livestock Census in the Kingdom of Serbia on December 31st 1910. (1911, pp. 4, 5); Jagodić (2013, pp. 132, 133); Population Census of January 31st 1921. The Definitive Results. (1932, pp. 2-122); Authors' calculations.

demographic loss. Estimated demographic loss for 1911/1913-1921 is equal to the difference between the estimated number of inhabitants who would have lived in Serbia in 1921 had the war not taken place and the actual figure recorded by the 1921 census. To estimate the number of inhabitants who would have lived in Serbia in 1921 had the war not taken place we calculated the average geometric annual growth rate of the population in North Serbia in the period 1906-1911 on the basis of available data, and then assumed that this average annual growth rate of population would continue in the future, assumed to be a warless period. Also, since there is no available data on population in South Serbia in 1906, we assumed that the calculated population annual growth rate for North Serbia would also prevail in South Serbia (Table 2).

Table 2. Serbia's estimated demographic loss in the period between 1911/1913 and 1921

	Census 1906	Census 1911/1913	Average geometric annual growth rate 1906-1911	Estimated population 1921	Census 1921	Estimated demographic loss 1911/ 1913-1921
North Serbia	2724859	2911701	1.43%	3359229	2598151	761078
South Serbia	na	1481614		1661186	1270006	391180
Serbia total	na	4393315		5020415	3868157	1152258

Sources: Population and Livestock Census in the Kingdom of Serbia on December 31st 1905. The First Results. (1906, pp. VI-VII); Population and Livestock Census in the Kingdom of Serbia on December 31st 1910. (1911, pp. 4, 5); Jagodić (2013, pp. 132, 133); Population Census of January 31st 1921. The Definitive Results. (1932, pp. 2-122); Authors' calculations.

The estimated demographic loss of Serbia represents a quarter of its 1911/1913 population. Other authors who had previously dealt with this subject have reached similar results (Vrućinić 2007, pp. 83-90, 165-168). However, Serbia's official report on the absolute loss of lives during WWI, presented to the Paris Peace Conference in 1919, gives different figures: 1,247,435 in total, of whom 402,435 were soldiers and 845,000 were civilians (311,000 males under the age of fifteen and 534,000 others) (Rapport sur les Dommages causes à la Serbie et au Monténegro présenté à la Commision des Réparations des Dommages 1919, p. 14). Although there is no obvious reason to doubt the number of military casualties, the total is excessive compared with the data presented in Table 2. The number of civilian casualties was probably overestimated in Serbia's official report.

Loss of population caused changes in Serbia's demographic structure and greatly reduced the human labour force left in the country. Available data on the gender structure of Serbia's population in 1911/1913 and 1921 are presented in the following table (Table 3).

Table 3. Sex structure of Serbia's population in 1911/1913 and 1921

	1911/1913					1921					Difference 1911-1921			
	Males		Females		Total	Males		Females		Total	Males		Females	
	Absolute	%	Absolute	%		Absolute	%	Absolute	%		Absolute	%	Absolute	%
North Serbia	1503511	51.64	1408190	48.36	2911701	1244709	47.91	1353442	52.09	2598151	-258802	-17.21	-54748	-3.89
South Serbia	na	na	na	na	1481614	629875	49.60	640131	50.4	1270006	na	na	na	na
Serbia total	na	na	na	na	4393315	1874584	48.46	1993573	51.54	3868157	na	na	na	na

	Male-female ratio			
	1911/1913		1921	
	Males	Females	Males	Females
North Serbia	1000	936	1000	1087
South Serbia	1000	na	1000	1016
Serbia total	1000	na	1000	*1063*

Sources: Population and Livestock Census in the Kingdom of Serbia on December 31st 1910. (1911, pp. 4, 5); Population Census of January 31st 1921. The Definitive Results. (1932, pp. 2-122); Authors' calculations.

Combined data on the age and gender structure of Serbia's population in 1921 are presented in Table 4. Unfortunately, the 1911 and 1913 censuses do not contain information about the population's age structure, so comparison is not possible.

Table 4. Age and sex structure of Serbia's population in 1921[6]

	Percentage of Serbia's population in 1921 by age and sex									
	Years of age	Males			Females			Total		
		N. Serbia	S. Serbia	Serbia	N. Serbia	S. Serbia	Serbia	N. Serbia	S. Serbia	Serbia
Age group	0 to 14	17.10	22.40	18.84	16.55	19.06	17.37	33.65	41.46	36.20
	15 to 54	25.36	19.69	23.50	29.69	24.58	28.02	55.06	44.27	51.53
	From55	5.45	7.51	6.12	5.84	6.76	6.14	11.29	14.27	12.26
	Unknown	0.01	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.01
	Total	47.92	49.60	48.47	52.08	50.40	51.53	100.00	100.00	100.00

Source: Population Census of January 31st 1921. The Definitive Results. (1932, pp. 386-413); Authors' calculations.

Based on the presented data, it can be concluded that the most important section of the labour force, i.e., males between 15 and 54 years of age, made up less than a quarter of Serbia's population in 1921. Furthermore, some of the overall population were invalids of war, partly or completely incapable of work. The census

[6] The population of North Serbia, and therefore of the whole country, is larger by12,418 inhabitants in this table than in Tables 1, 2, and 3. This is because age-group data in the 1921 census are available only by district and not by community, so the population of communities ceded by Bulgaria in 1919 and attached to Krajina and Timok counties could not be subtracted.

does not provide their exact number but, according to data presented by the Kingdom of Serbs, Croats, and Slovenes' delegation at the Peace Conference in Paris, there were 264,000 invalids in Serbia (114,000 military and 150,000 civilians) (Rapport sur les Dommages causes à la Serbie et au Monténegro présenté à la Commision des Réparations des Dommages 1919, p. 15). However, as mentioned, these figures cannot be verified.

4. AGRICULTURE

The Kingdom of Serbia's population was predominantly rural, both before and after the First World War, as presented in Table 5.

Table 5. Urban and rural population of Serbia according to 1911/1913 and 1921 censuses.

	Population 1911/1913					Population 1921					Difference 1921-1911/1913			
	Urban		Rural		Total	Urban		Rural		Total	Urban		Rural	
	Absolute	%	Absolute	%	absolute	absolute	%	absolute	%	absolute	absolute	%	absolute	%
North Serbia	384822	13.22	2526879	86.78	2911701	430336	16.56	2167815	83.44	2598151	45514	11.83	-359064	-14.21
South Serbia	376700	25.42	1104914	74.58	1481614	334219	26.32	935787	73.68	1270006	-42481	-11.28	-169127	-15.31
Serbia total	761522	17.33	3631793	82.67	4393315	764555	19.77	3103602	80.23	3868157	3033	0.40	-528191	-14.54

Sources: Isić (1995, p. 9); Jagodić, (2013, p. 136); Population Census of January 31st 1921. The Definitive Results. (1932, pp. 2-122); Authors' calculations.

Agriculture was the country's main occupation. According to the last available pre-WWI data, in 1900 84.23% of (North) Serbia's 2,492,882 inhabitants supported themselves by agriculture (Jagodić 2010, p. 328). However, at the end of the 19th century signs of agricultural overpopulation had begun to appear. Mechanical population growth in (North) Serbia had been negative since 1890.[7] In 1897 there were 34,952 village households without any land, while 67,668 village households owned dwarf and unprofitable landholdings of up to 2.5 hectares. Since industry was underdeveloped, cities were unable to absorb surplus rural population. A chance to resolve this problem occurred in 1913, after the new regions were annexed. South Serbia was not nearly as densely populated as North Serbia and it had vast areas of state land suitable and available for colonization. A decree on colonization was enacted in March of 1914, but the outbreak of WWI prevented its realization. Agricultural overpopulation in North Serbia was overcome by demographic losses suffered during the war, instead of by colonization (Jagodić 2013, pp. 317-318). The urban population increase in North Serbia noted in 1921[8] is a clear

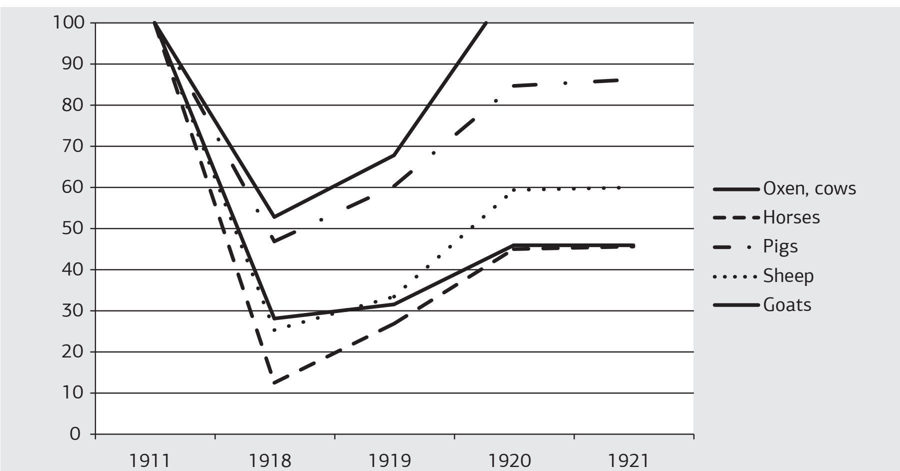
[7] Mechanical growth of population is equal to the difference between immigration and emigration.

[8] This especially refers to Belgrade: its population increased from 82,498 in 1911 to 111,739 inhabitants in 1921 (35.4% increase).

indication of the poor state of agriculture after the war (Table 5). The decrease of the same population group in South Serbia was caused by the emigration of Turks, who were predominant city dwellers, to the Ottoman Empire.

Serbia's livestock fund had diminished during the Balkan wars, and was devastated during WWI. Up until the retreat of 1915, livestock was used to fulfil the needs of the Serbian Army; land was then requisitioned by the occupying countries and used in their war effort. According to the official assessment of the Serbian authorities after the war, Bulgarian occupiers, who held two thirds of Serbian territory, transferred approximately 500,000 oxen and cows, 100,000 horses, 500,000 pigs, 2,000,000 sheep, and 500,000 goats to Bulgaria. The Austro-Hungarians did not lag behind in this respect. The occupying forces regularly requisitioned harvested crops, agricultural tools and machines, and anything else needed for their own supplies (Isić 1995, pp. 26-29; Rapport sur les Dommages causes à la Serbie et au Monténegro présenté à la Commision des Réparations des Dommages 1919, pp. 77-80). There are no exact data on pre-WWI livestock in Serbia (North and South), because no livestock census had been conducted in the new regions after annexation. Comparison of livestock numbers before and after the war can only be made for North Serbia, where livestock was counted simultaneously with population in 1911 (census of January 13th 1911). The following figure (Figure 1) represents post-WWI recovery of livestock in North Serbia in percentages, where values recorded by the 1911 census are marked as 100%.

Figure 1. Recovery of livestock fund 1918-1921 in North Serbia in percentages compared with 1911 livestock fund[9]



Source: Isić (1995, p. 49).

[9] Percentage values for 1919, 1920, and 1921 are slightly overestimated, because the figures they are derived from include livestock in the territories ceded by Bulgaria in 1919 (two districts and several communities).

Exact absolute and relative (per 1000 inhabitants) numbers of livestock in North Serbia according to censuses conducted in 1911 and 1921 are presented in Table 6.

Table 6: Livestock fund in North Serbia in 1911 and 1921[10]

	Livestock in North Serbia							
	Absolute		Increase/decrease 1911-1921		Absolute per 1000 inhabitants		Increase/decrease per 1000 inhab. 1911-1921	
	1911	1921	Absolute	%	1911	1921	Absolute	%
Horses	152617	65242	-87375	-57.25	52.42	25.11	-27.30	-52.09
Cows, oxen	957918	1036482	78564	8.20	328.99	398.93	69.94	21.26
Buffalos	7290	6563	-727	-9.97	2.50	2.53	0.02	0.89
Donkeys	871	1526	655	75.20	0.30	0.59	0.29	96.34
Mules	349	2300	1951	559.03	0.12	0.89	0.77	638.56
Pigs	863544	735155	-128389	-14.87	296.58	282.95	-13.62	-4.59
Sheep	3808815	2186996	-1621819	-42.58	1308.11	841.75	-466.36	-35.65
Goats	627427	271227	-356200	-56.77	215.48	104.39	-111.09	-51.55

Sources: Population and Livestock Census in the Kingdom of Serbia on December 31st 1910. (1911, pp. 80-81); Population and Livestock Census in the Kingdom of Serbs, Croats and Slovenes on January 31st 1921. (1927, pp. 12-17); Authors' calculations.

Based on the presented data, it can be concluded that North Serbia's livestock fund had generally decreased due to the Balkan wars and especially WWI. Post-war recovery was insufficient, apart from oxen and cows. This exception could be explained by peasants' personal efforts to re-supply rural households with large working cattle, necessary for land cultivation.[11]

Demographic loss, livestock diminishment, and an estimated 40% decrease of agricultural tools, devices, and machines, plundered or ruined during occupation, led to a decline of cultivated areas imminently after the war (Isić 1995, p. 42). According to the official censuses, the total cultivated area in North Serbia was larger in 1904 than in 1921 (pre-WWI data for South Serbia are not available). Comparison between the two censuses is presented below (Table 7).[12]

[10] Livestock from Caribrod and Bosilegrad districts, ceded by Bulgaria in 1919, is not included in values for 1921.

[11] War indemnity courts began to operate in April of 1921, i.e., after the 1921 census had been conducted. Isić (1995), pp. 28-29, 37-44, 51; Population and Livestock Census in the Kingdom of Serbs, Croats and Slovenes on January 31st 1921 (1927), pp. X-XII.

[12] The last pre-WWI census of cultivated areas was conducted in 1904. Results of the 1921 census are published only for counties and not for districts or communities, so the 1921 territory of North Serbia is larger for two districts and several communities. The population census chronologically closest to the 1904 agricultural census was conducted in 1905 (the critical date was 31st December 1905/13th January 1906).

Table 7. Cultivated areas in North Serbia in 1904 and 1921

	Hectares of cultivated area						Hectares per 1000 inhabitants			
	1904		1921		Difference 1904-1921		1904/1906	1921	Difference 1904/1906-1921	
	Absolute	%	Absolute	%	Absolute	%			Absolute	%
Maize	540890.15	31.55	505391.23	32.78	-35498.92	-6.56	198.50	190.23	-8.27	-4.17
Wheat	366409.42	21.37	374548.18	24.29	8138.76	2.22	134.47	140.98	6.51	4.84
Rye	45119.94	2.63	34578.45	2.24	-10541.49	-23.36	16.56	13.02	-3.54	-21.40
Barley	98998.73	5.77	65281.28	4.23	-33717.45	-34.06	36.33	24.57	-11.76	-32.37
Oats	104868.05	6.12	76095.53	4.94	-28772.52	-27.44	38.49	28.64	-9.84	-25.58
Spelt	6169.45	0.36	3108.21	0.20	-3061.24	-49.62	2.26	1.17	-1.09	-48.33
Millet	256.54	0.01	175.18	0.01	-81.36	-31.71	0.09	0.07	-0.03	-29.96
Buckwheat	1718.1	0.10	743.6	0.05	-974.5	-56.72	0.63	0.28	-0.35	-55.61
Other cereals	0	0.00	4006.52	0.26	4006.52	/	0.00	1.51	1.51	/
Subtotal	1164430	67.92	1063928	69.01	-100502	-8.63	427.34	400.47	-26.87	-6.29
Legumes	8469.83	0.49	28853.87	1.87	20384.04	240.67	3.11	10.86	7.75	249.40
Vegetables	25797.19	1.50	36325.98	2.36	10528.79	40.81	9.47	13.67	4.21	44.42
Subtotal	34267.02	2.00	65719.85	4.26	31452.83	91.79	12.58	24.74	12.16	96.71
Plum, orchards	151376.81	8.83	106909	6.93	-44467.81	-29.38	55.55	40.24	-15.31	-27.56
Vineyards	33876.08	1.98	25297.62	1.64	-8578.46	-25.32	12.43	9.52	-2.91	-23.41
Subtotal	185252.9	10.81	132206.6	8.57	-53046.3	-28.63	67.99	49.76	-18.22	-26.80
Ind. plants	14903.41	0.87	14535.38	0.94	-368.03	-2.47	5.47	5.47	0.00	0.03
Meadows, clovers	315521.08	18.40	265928.24	17.25	-49592.84	-15.72	115.79	100.10	-15.70	-13.56
Total	1714375	100.00	1541778	100.00	-172597	-10.07	629.16	580.33	-48.83	-7.76

Note: Serbia's population on January 13th 1906 was 2,724,859.
Sources: Kingdom of Serbia's Statistics, vol. XXXI. (1913, pp. I-XXXI); Cultivated Land and Crop Production in 1921 and 1922. (1922, pp. 18-72); Population and Livestock Census in the Kingdom of Serbia on December 31st 1910. The First Results. (1911, pp. 4, 5); Authors' calculations.

An absolute and relative decrease of cultivated areas was omnipresent, apart from for legumes and vegetables - a direct consequence of a distorted male-female ratio, as cultivation of vegetables and legumes was traditionally women's domain. The presented data shows the disastrous state of North Serbia's agriculture after the war. Unsurprisingly, hunger, poverty, and misery ruled the countryside (Isić 1995, p. 34).

5. INDUSTRY

Noticeable industrialization had begun in Serbia at the end of the 19th century. Industrial development gained some momentum during the first decade of the 20th century, partly due to the 'Customs war' between Serbia and Austria-Hungary (1906-1911). According to certain estimates, around 7% of (North) Serbia's population was engaged in craft and industry in 1910, while domestic industrial production in the broadest sense of the term constituted around 10% of the national GDP in 1910 (Đurović 1969, p. 173; Palare 2010, pp. 380-381, 384). The main industries were textiles, food, cement, wood, leather, and arms production, as well as several mines (coal and copper) (Vučo 1981, pp. 85-378). Serbia's railway infrastructure was modest. It is indicative that in 1910 three times more income was generated by cart transport than by railway transport (Palare 2010, p. 381).

According to Serbia's Industrial Chamber data, industrial production had sharply declined at the beginning of the WWI, even before the occupation of the country. Immediately after the occupation, enemy forces requisitioned raw materials, industrial products, machines, etc. left in Serbia, and transported them to their own countries. The Austro-Hungarian occupying authorities exploited mines for their own industrial production (Ripanj, Rudnik, Rtanj, Vlaška, Krupanj, Aleksinac, Senj). Just before retreating from Serbia in 1918 the occupational forces disabled the mines with flood or fire. According to Serbian official data collected right after the war, all coal mines and half of the metal mines were completely ruined. At the same time other industrial facilities, for example, the arms factory in Kragujevac, were plundered and destroyed. Out of around 450 industrial facilities that had existed in Serbia in 1910, only 95 were left in July of 1919, and few were operational. The owners lacked the capital necessary to renew production, while the Government's assistance was slow and insufficient, at least according to the Industrial Chamber (Đurović 1969, pp. 178-183; Industrial Chamber in Belgrade 1921, pp. 29-32). In 1919 the Serbian military requisitioned and transferred certain industrial installations from parts of occupied Hungary, but this was insufficient to compensate for the damage (Đurović 1969, pp. 197-198). In addition, the railways, bridges, and roads were severely damaged, so transport of any kind was hindered. Therefore, it may be concluded that Serbia after WWI was in need of overall reindustrialization.

6. THE STATE BUDGET, WAR FINANCING, AND THE EXTERNAL DEBT

One of the characteristics of the Great War was that almost all involved countries used inflation to finance the war economy.[13] Due to the accumulation of huge debts, the drastic decline in production, and the increasing costs of reconstruction

[13] At the beginning of the Great War, countries involved in conflict financed their war operations through the introduction of new taxes and selling governments bonds. However, as time passed, this channel of funds proved insufficient, which forced economies in war to suspend convertibility of their currencies into gold or foreign exchange and issue fiat money. The greater the gap between issued fiat money and gold and foreign exchange reserves, the greater the inflation and volatility of domestic exchange rates. (Eichengreen 2008).

and reparations, hyperinflation remained an acute problem in Germany, Austria, Hungary, Poland, Italy, Romania, and Bulgaria in the aftermath of the war. On the other hand, Serbia predominantly financed its war costs by borrowing from the allies, pledging its national wealth as collateral. In other words, the Serbian costs of war had been entirely backed by gold, silver, loans, and letters of credit from the allied forces.

When the war began the Serbian Government exchanged its gold for the paper money backed by gold and silver issued by the Privileged National Bank of the Kingdom of Serbia (Privilegovana Narodna Banka Kraljevine Srbije). Since this source of funding eventually dried up, Serbia turned to loans and letters of credit granted by allied countries, which further supported the issuance of the paper money, this time backed only by silver. From the beginning of WWI to the withdrawal of the Serbian Army to Greece in late 1915, Serbia 's debt to England and France grew by 520 million gold francs (Gnjatović 1991, pp. 110-119).

In 1914 and the most of 1915, when the war was fought in North and Western Serbia and then across the whole of Serbian territory, the Serbian budget experienced a typical pattern of changes in state revenues and costs. During 1914 the Serbian authorities collected only 57.9% of planned budget revenue and spent 57.8% of planed budget expenditure, which eventually led to a balanced budget. A similar pattern was repeated the next year when the Government collected only 28.55% of planned budgeted revenue and spent 36.82% of planned expenditure. The drastic decline in tax revenue was the result of the Government's inability to collect taxes in the war-torn country, where in 1915 the main state roads were controlled by occupying forces. Savings in expenditure occurred predominantly in the Ministry of Construction (Ministarstvo građevine), due to the cancellation of large and expensive infrastructure projects. Budget expenditure was also reduced by the government decision in 1914 to transfer half of the planned military costs and in 1915 to transfer total planned military costs from the state budget to a separate extraordinary war budget (Gnjatović 1991, pp. 110-119). The only expenses that materialized in accordance with the plan were the state administration expenditures (Vrhovna državna uprava).[14]Additionally, in 1915 Serbia ceased to service its debts to creditors from the invading countries (Austria and Germany).

Immediately after the Serbian Army had retreated from the territories of the Kingdom of Serbia, the Serbian Government settled down in Corfu. As it was displaced the Serbian Government was deprived of budget revenues and its expenditures (military and civilian) and debts had to be covered by loans from allied countries. Because of the crucial role of the Serbian Army in the allied countries' plans for the liberation of the occupied Balkan territories, France and England in 1916 assumed the financing of all Serbian expenditures (army, administration apparatus, pensions, repayment of debts accrued, assistance to disabled persons, refugees,

[14] Salaries and pensions of state employees.

prisoners of war, and internees). This financial arrangement lasted until the end of WWI. An additional source of financing of Serbian state expenditure emerged in April 1917 when the United States entered the war. Thereafter the Serbian authorities borrowed a million US dollars per month from the U.S. government (Gnjatović 1991, pp. 110-119).

At the end of the Great War in the Treaty of Versailles (28 June 1919), the victors imposed war reparations on the defeated countries. Germany, Austria, Hungary, and Bulgaria were obliged to disarm, to make territorial concessions, and to pay 132 billion marks in war reparations. The share of Germany alone was 120 billion marks, 5% of which should have been transferred to the Kingdom of Serbs, Croats, and Slovenes. Austria, Hungary, and Bulgaria owed the Kingdom of Serbs, Croats, and Slovenes 10% of their war reparations (Gnjatović 1991, pp. 110-119). The total war reparation claimed by the Kingdom of Serbs, Croats, and Slovenes was 7.2 billion marks, more than enough to meet all debt obligations accumulated during the war. Consequently, in the following years Serbia entered into a number of treaties with creditors that regulated the total amount of its debt (principal and interest payments) and the time schedule of debt repayment (Table 8).

Table 8. Amounts and time schedule of Serbia's debts repayments to allied countries

Country	Date of signing treaty	Amount of debt	Years of debt amortization
USA	03-May-26	62.85 million dollars	62
England	09-Aug-27	25,6 million pounds sterling	62
England	09-Aug-27	3.1 million pounds sterling to pay off debt in kind	15
France	20-Jan-30	1.02 billion franks	37

Source: Gnjatović (1991, p. 110-119).

However, the "Carthaginian peace", as John Maynard Keynes named it, imposed on Germany overburdened the German state budget, forcing the German government to proclaim a moratorium on its other debt until all war reparations were paid.[15] Since debt repayment between Entente countries depended heavily on the

[15] The seminal British economist John Maynard Keynes, in his masterpiece *The Economic Consequences of the Peace* (1920), questioned the effectiveness of the harsh war reparation conditions imposed on Germany: "My purpose in this book is to show that the Carthaginian peace is not practically right or possible. Although the school of thought from which it springs is aware of the economic factor, it overlooks, nevertheless, the deeper economic tendencies which are to govern the future." (Keynes 1920, p. 15). As he saw it, the actual outcome of the Treaty of Versailles was that paying for the war damage was the sole responsibility of the defeated countries, which he thought was unsustainable without help from the winning side. In his opinion, this resolution was to the mutual disadvantage of all European countries, since in order to pay off its excessive debts Germany would be forced to increase its trade surplus at the expense of local inhabitants' standards of living, as well as of production and employment in other European countries. This certainly contributed once again to the increase in economic disparity between the core European countries, and led to mutual hostility which culminated in the outbreak of the WWII only two decades later.

capacity of Germany to pay off war reparations, as soon as Germany defaulted in 1931, the Kingdom of Serbs, Croats, and Slovenes also stopped servicing its debt to the U.S., Britain, and France. The same was true for the other victorious countries. The general opinion was that the evaporation of the German capacity to service its war reparation obligations diminished the possibility of Entente countries regulating mutual debt obligations. Thus the problem of accumulated war debts was permanently removed from the agenda of international diplomacy.

7. CONCLUSION

The consequences of the Great War for the economy of Serbia, a country whose territory became one of its bloodiest battlefields, were disastrous. Serbia's estimated demographic loss amounted to a quarter of its pre-war population. Loss of population caused adverse changes in the demographic structure, so that the most important part of the labour force (males from 15 to 54 years of age) constituted less than a quarter of Serbia's population in the post-war period; not to mention that a significant portion of the overall population were invalids of war, partly or completely incapable of work. Considerable demographic loss, livestock diminishment, a huge decrease in agricultural tools, devices, and machines plundered or ruined during occupation, and the decline of cultivation immediately after the war left Serbian agriculture in shambles. Not surprisingly, hunger, poverty, and misery ruled throughout the countryside. The same was true for the underdeveloped industry, which also suffered great losses. In the end, in order to finance the war, the Serbian authorities chose not to use inflation and opted for increasing its external debt to the allied countries. However, as soon as Germany defaulted on its war reparation obligations in 1931, Serbia also stopped servicing its external debts accumulated during the war.

REFERENCES

Berend, I. (2006), *An Economic History of Twentieth-Century Europe*, Cambridge University Press, Cambridge.

Definitivni rezultati popisa stanovništva od 31. januara 1921 (Population Census of January 31st 1921. The Definitive Results). (1932), Opšta državna statistika Kraljevine Jugoslavije, Sarajevo.

Đurović, S. (1969), "Industrija Srbije na početku privrednog života Kraljevine Srba, Hrvata i Slovenaca (Serbia's industry at the beginning of Kingdom of Serbs, Croats and Slovenes' economic life)" *Istorija XX veka*, Vol. 10, Pp 167-223.

Eichengreen, B. (2008), *Globalizing capital. A History of the International Monetary System*, Princeton University Press, Princeton.

Gnjatović, D. (1991), *Stari državni dugovi. Prilog ekonomskoj i političkoj istoriji Srbije i Jugoslavije 1862-1941 (Old State Debts. Contribution to the Economic and Political*

History of Serbia and Yugoslavia 1862-1941), Ekonomski institut, Jugoslovenski pregled, Beograd.

Industrijska komora u Beogradu. (1921), *Izveštaj o radu 1914-1920 (Industrial Chamber in Belgrade, Report on activities 1914-1920)*, Beograd.

Isić, M. (1995), *Seljaštvo u Srbiji 1918-1925 (Peasants in Serbia 1918-1925)*, Institut za noviju istoriju Srbije, Beograd.

Istorija srpskog naroda VI-2 (History of the Serbian People) (1983), Srpska književna zadruga, Beograd.

Jagodić, M. (2010), "Kragujevac u drugoj polovini 19. veka u svetlu statistike (Statistics of Kragujevac in the second half of the 19th century)" *Istorijski **časopis***, Vol. 40, Pp 321-340.

Jagodić, M. (2013) *Novi krajevi Srbije (1912-1915) (The New Regions of Serbia 1912-1915)*, Filozofski fakultet Univerziteta u Beogradu, Beograd.

Keynes, J.M. (1920), *The Economic Consequences of the Peace*, Harcourt Brace, New York (www.Abika.com)

Maddison, A. (1995), *Monitoring the World Economy 1820-1992*, OECD, Paris.

Mitrović, A. (1981), *Prodorna Balkan. Srbija u planovima Austro-Ugarske i Nemačke 1908-1918 (Penetration into the Balkans. Serbia in Austria-Hungary and Germany's plans 1908-1918)*, Nolit, Beograd.

*Obradjena zemlja i **ž**etveni prinos u 1921. i 1920. godini* (*Cultivated Land and Crop Production in 1921 and 1922)* (1922), Državna statistika Kraljevine Srba, Hrvata i Slovenaca, Beograd.

Palare, M. (2010), *Balkanske privrede oko 1800-1914. Evolucija bez razvoja*, (*The Balkan Economies c. 1800-1914. Evolution without development*), Službeni glasnik, Beograd.

Prethodni rezultati popisa stanovništva i domaće stoke u Kraljevini Srbiji 31. decembra 1905 (Population and Livestock Census in the Kingdom of Serbia on December 31st 1905. The First Results). (1906), Državna statistika Kraljevine Srbije, Beograd.

Prethodni rezultati popisa stanovništva i domaće stoke u Kraljevini Srbiji 31. decembra 1910 (Population and Livestock Census in the Kingdom of Serbia on December 31st 1910. The First Results). (1911), Državna statistika Kraljevine Srbije, Beograd.

Rapport sur les Dommages causes à la Serbie et au Monténegro présenté à la Commision des Réparations des Dommages. (1919), Délégation du Royaume des Serbes, Croates et Slovènes à la Conférence de la Paix, Paris.

Rezultati popisa domaće stoke u Kraljevini Srba, Hrvata i Slovenaca od 31. januara 1921. godine (*Population and Livestock Census in the Kingdom of Serbs, Croats and Slovenes on January 31st 1921*). (1927), Državna statistika Kraljevine Srba, Hrvata i Slovenaca, Sarajevo.

Statistika Kraljevine Srbije, knjiga XXXI (*Kingdom of Serbia's Statistics, vol. XXXI*). (1913), Državna statistika Kraljevine Srbije, Beograd.

Vrućinić, D. (2007), *Demografski gubici Srbije prouzrokovani ratovima u XX veku (Demographic losses of Serbia caused by wars in the XX century)*, Muzej žrtava genocida, Belgrade.

Vučo, N. (1981), *Razvoj industrije u Srbiji u 19.veku (Industrial development in Serbia in the 19th century)*, SANU, Beograd.

Chapter 13

The Economic Problems of Bulgaria During the First World War and Changes in its Economic Policy

Rumen Andreev*
E-mail: randreev@mail.bg

Abstract: The wars for the unification of Bulgaria at the beginning of the 20th century had severe consequences for its economy. In the course of just seven years the country participated in three unsuccessful wars and the peace treaties had grave consequences for its economy. The present paper analyses the changes that occurred in the Bulgarian economy during and after the First World War and the state's imposition of protectionism to aid economic recovery after the war.

Key Words: First World War, Economy, Gold Standard, Inflation, Debts

JEL: B19, N14, N44, N54

The rising economic development of Bulgaria at the beginning of the 20th century was interrupted by the country's wars of unification. By the beginning of the 1912 Balkan War the country was maintaining the stability of its currency by sticking to the gold standard, was producing agricultural products for consumption and export, and was trying to develop its industry. Bulgaria had good trade relations with neighbouring countries, and the state budget was balanced with a small deficit. Notwithstanding the wars that the country waged in 1912-13 and the losses in terms of people and money, plus the territorial changes, the economic situation remained relatively good.

Bulgaria entered the First World War in October 1915 on the side of the Central Powers, which isolated the country from its traditional markets and forced it to rely on its own production and trade with its allies. During the war, agricultural production, which in the years of peace had made Bulgaria self-sufficient and created a surplus for export, could not produce enough to feed the population and the army. Twenty per cent of Bulgaria's population was mobilized, one of the largest proportions amongst all countries involved. Much of the cattle was requisitioned for the army.

* University of National and World Economy - Sofia

There were also problems in public finances. During the war the state budget had a deficit, which was financed by short-term loans from the Bulgarian National Bank (BNB)[1]. The BNB's emission of banknotes increased by about 14 times, which devalued the Bulgarian lev and raised the price of goods. The supply of essential products and trade in foreign currency became state monopolies. Internal and external debt increased. Unfavorable loans were agreed with Germany and Austria-Hungary.

1. MONETARY AND FISCAL POLICY

1.1. Banknote Circulation without a Gold Standard

The countries involved in WWI (except the UK) financed the war by abandoning the gold standard and increasing the banknotes in circulation. In late July 1914 the banknotes in circulation in the UK, Germany, France, Russia, Austria-Hungary, and Italy were worth 18 billion levs, with gold reserve of 13 billion levs, and at end of September 1918 they were worth 130 billion levs with gold reserve of 15 billion levs. Thus the banknotes in circulation had increased by 662% and gold holdings by only 11% (Kolev 1919).

Before the beginning of the First Balkan War in 1912, the BNB had established itself as a central bank that financed the state, the municipalities, and other commercial banks. The bank endorsed the gold standard by removing the premium of exchange between gold and silver and maintained gold holdings so that the banknotes in circulation did not exceed more than three times the gold reserve. The repeal of the gold standard in the same year and the increase of military spending and state debt caused inflation that continued until the formal stabilization of the lev in 1924. The convertibility of the lev against gold was removed on October 10, 1912, only five days after the start of the First Balkan War, which turned banknotes into discretionary paper money[2]. During the wars the banknotes in circulation in Bulgaria increased from 111 million levs in 1913 to 2,299 million levs in 1918, as from the end of 1914 to the end of 1918 banknote circulation increased more than ten times while the debt of the country increased more than thirty times. Bulgaria issued the second largest amount of banknotes after Germany. The BNB tried to increase its gold and silver reserves by buying gold, but at a rate significantly lower than the growth of banknotes in circulation (Russenov (ed.) 1983).

---

[1] The Central Bank of Bulgaria.

[2] The law on the termination of the exchange of banknotes for gold was adopted seven years later, on Jan 3, 1919.

Table 1. Ratio of banknotes in circulation and gold and silver availability in cash in thousands at the end of 1920

Countries	Gold and Silver money in cash	Banknotes in circulation	% banknotes to the availability in cash
Netherlands	656,312	1,080,319	164.6
Germany	1,098,504	63,104938	5,774.6
England	124,112	127,965	103.1
France	5,756,553	38,806,733	674.1
U.S.A.	2,003,320	3,351,303	167.3
Bulgaria	54,001	2,803,706	5,242.0

Source: Chronicle (1920). Journal of the Bulgarian Economic Association. XIX.9-10, p. 550

After the armistice in 1918 the BNB continued to increase the banknotes in circulation and create inflation. Due to the poor harvest in 1919, the state had to import flour worth 27 million levs from the U.S.A., which it paid for in gold levs, thus reducing BNB reserves from 64 million levs to 37 million levs.[3] The depreciation of the German mark caused a loss in the bank's German assets, which were frozen after the war (Russenov (ed.) 1983).

On December 19, 1918 a foreign exchange monopoly called the Headquarters of foreign currency was established in Bulgaria, which included the BNB and 19 private banks.[4] The Headquarters determined the exchange rate for buying and selling foreign currency, and the free trade in foreign exchange was that remaining after the needs of the state had been met. In 1920 the Headquarters of foreign currency was closed and BNB was entitled to buy 30% of the foreign exchange received from exports (Russenov (ed.) 1983).

The foreign exchange monopoly failed to reduce the depreciation of the lev, and its introduction was an attempt to reduce the lev's external exchange rate. In the years following the war the Headquarters of foreign currency acted as a fiscal institute, buying one-third of the foreign currency imported to the country at a lower-than-market rate. The Headquarters of foreign currency set the precedent of the BNB having the monopoly to buy and sell foreign currency, which the bank also took advantage of in subsequent years (Hristoforov 2010).

The Ordinance of December 1923 granted the BNB a full monopoly on foreign exchange, and in 1924[5] a law was passed giving the bank full control of foreign exchange trade and determining foreign exchange rates, and prohibiting the export of Bulgarian banknotes. The BNB monopoly restored confidence in the Bulgarian lev and formally stabilized it and the exchange rate of the lev to the US dollar

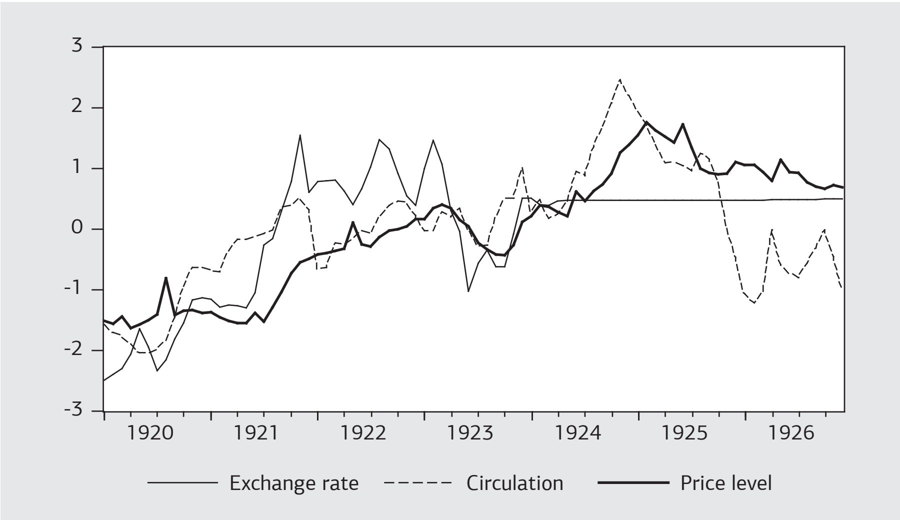
[3] The Government tried to get wheat instead of flour by paying for imports against a pledge of gold for a certain period, but the proposal was not accepted (Russenov (ed), 1983, 511).

[4] Law on Trade with Foreign Means of Payment, Loans, and Receivables (State Gazette, issue 286 of Dec 19, 1918). The law was modelled on the foreign exchange monopoly in Germany, introduced in 1916 (Hristoforov, 2010, vol. I, 363).

[5] State Gazette issue 24, May 2 1924.

remained constant until the official stabilization of the lev in 1928 (Russenov (ed.) 1983).

Figure 1. Bulgaria (1920–1926). Price level, money in circulation and exchange rate (lev-US dollar) (normalized scale)



Source: Nenovsky and Andreev (2013) Bulgarian Economists on the Great Depression, Sofia.

1.2. Post-war Attempts to Restore the Gold Standard

In 1922 a conference of 34 countries in Genoa decided to partially restore the gold standard, which had been abandoned during the First World War. The countries attending the conference, including Bulgaria, assumed that this would facilitate international trade and restore their economic stability. Although most central banks wanted the return of the gold standard, they preferred a foreign currency standard wherein payments were made by banknotes not directly convertible to gold - an accepted gold foreign currency standard, where gold reserves did not leave the bank safety vault.

At the Genoa Conference it was proposed that the group of countries (center countries) should hold their currency reserves in gold, and the second group (periphery) countries should hold their currencies partly in gold and partly in short-term receivables from the central countries.

The proposal was designed to restore the gold standard while avoiding a shortage of gold. Once the global economy was on the rise the peripheral countries' demand for reserve currency increased, while the central countries were tempted to expand the money supply, increasing the liquidity of the reserve currency and risking the convertibility of the central currency against gold. The monetary stability of the peripheral countries depended on the countries in the centre, so that once one of the countries from the "pound bloc" had abandoned the gold standard the peripheral countries had to follow. This happened in 1931, when Great Britain abandoned the gold standard and forced the countries holding their reserves in pounds (Australia, Denmark, Portugal, Sweden) to do the same (Nenovsky and Andreev 2013).

In 1924, Bulgarian reforms aimed to transform the BNB into a modern emission bank. A gold foreign currency devises standard was introduced, under which banknotes issued by the BNB had to have an equivalent gold reserve of one-third of their value. The currencies of countries that adhered to the gold standard could also be held as a reserve (according to the 1922 Genoa Conference); however, the population could not actually exchange banknotes for gold, as in the standard gold exchange (Nenovsky and Andreev 2013).

The BNB kept the gold standard in the following years, and in 1928 the Bulgarian lev was legally stabilized by a law under which one gram of gold was exchanged for 92 levs. Bulgaria tried to pay its reparation debts after the beginning of the Great Depression and was one of the later countries to abandon the gold standard (on October 15, 1931) and devalue its currency.

The First World War proved that it was possible to reconstruct monetary circulation by removing the gold standard and for banknotes to be accepted as the main means of payment. Banknotes were already accepted for international payments, as the exchange rate was not correlated with gold but was the result of the economic and financial situation of the state (Kolev 1919).

1.3. Increase in Public Debt and Banknotes in Circulation to Finance the War

Bulgaria mainly financed the war by foreign loans. The government did not increase taxes during the war years (1912-1919): the tax revenue in the budget came from indirect taxes, and it reduced the collection of direct taxes (Todorov 1921).

When Bulgaria was preparing for war in 1914 it took a loan of 500 million gold francs from the Berlin bank trust, *Diskontogezelsheft*. The BNB held 50 million gold francs from the loan to build the Haskovo – Porto Lagos railway line and Porto Lagos Port (built by German companies) and 100 million francs for armaments from German and Austrian companies. The agreement obliged the bank to repay 75 million francs of loans from French banks dating from 1913 (which remained unfulfilled until 1921). The loan was secured by revenue from tobacco excise, revenue stamps and import duties. A contract to form a National Joint-Stock Company for Mines Exploitation (Bobov Dol and Pernik mines) was signed at the same time as the loan agreement. The actual amounts received by the Bulgarian government were two advances to the total value of 270 million gold francs (Russenov (ed.) 1983).

During the war Bulgaria received weapons on trust from Germany and Austria-Hungary, and its debts at the end of the war equaled 1 billion gold Swiss francs. Germany also received goods - mostly food - on trust from Bulgaria, as Germany's debt was greater than that owed for the weapons. Following the signing of the peace treaty the claims and obligations between the two countries were resolved (Russenov (ed.) 1983).

In the last four months of 1915 (Bulgaria began fighting on October 14, 1915) Germany and Austria-Hungary funded Bulgaria with an advance of 50 million levs each month. Initially the Central Powers intended the funding to be free, but after the refusal of the Bulgarian Minister of Finance, the funding was provided as a long-term loan at 6% interest. In September 1917 Germany again started to finance Bulgaria with monthly installments of 50 million levs, opening a Bulgarian account in *Diskontogezelsheft,* in which it had made 27 deposits totalling 1 billion 350 million levs by the end of the war. The Bulgarian government secured the loans by issuing treasury bills and then conceded the account in *Diskontogezelsheft* to the BNB, which utilized the amount available to issue banknotes, entering the amount as its asset. Germany reduced the account by 240 million levs from sold treasury bills and 120 million levs in banknotes for payment to German merchants trading in the Bulgarian market (Lyapchev 1919).

The BNB increased monetary circulation by directly financing the public debt. Other forms of financing - by raising taxes, borrowing from the population through issuing treasury bills, and through loans and open accounts from the commercial banks - were used less, due to the weak development of the credit system.

During the period of the wars the government was funded by the Central Bank, and its debt increased from 8 million levs before the First Balkan War, to 189 million levs after the Second Balkan War, and 881 million levs at the end of the First World War (1918) (Russnov (ed.) 1983). The increased rate of banknotes in circulation during the First World War was due to loans that the government received from the BNB. Throughout the period the BNB granted relatively few loans to trade, industry, and private banks, as most of the loans went on military supplies (Hristoforov 2010).

After the war the banknotes in circulation increased less than during the war period, from 2,297 million levs in 1918 to 3,886 million levs in 1922. The public debt raised much more, from 1,294 million levs in 1918 to 4,130 million levs in late 1922. That same year a law was passed restricting banknote issue and the liabilities of the treasury to the Bulgarian National Bank[6], so that the maximum amount that the bank could grant to the state was 4,700 million levs, which was approximately the amount the state owed the bank at the time. The law prohibited the granting of other loans to the state above that amount and obliged the bank to form a fund to repay the government's debt to the bank, as the bank's revenues had

[6] State Gazette, issue 70 of June 30, 1922

to be from interest equal to 2% of the released state debt. The law determined the maximum amount of banknotes in circulation, which were not to exceed twelve times the 57 million levs of the bank's metal reserves. The law established an independent credit policy for the bank, ended inflation, and regulated the money in circulation (Hristoforov 2010).

After Bulgaria joined the First World War the German assets of the BNB increased, as the government transferred its receivables from Germany to repay its debt to the bank. Thus it bound the stability of the Bulgarian lev to the German mark, which was also not exchanged for gold during the war (Russenov (ed.) 1983).

Table 2. Public debts of countries participating in the First World War

	Public debt at the end of 1913, billions of levs	Public debt at the beginning of 1918, billions of levs
England	18	169
Germany	25,5	137
France	31	109
Russia	23,5	127
Austria-Hungary	15,5	82
Italy	13,5	37

Source: Kolev K. (1919), Monetary circulation during the war, Journal of the Bulgarian Economic Association, XIX. 1-2, p.16

The Bulgarian economy supported the Bulgarian army, as well as three German divisions on the southern front, and exported raw materials to Germany. Bulgaria provided supplies for the three German divisions without obtaining the goods agreed with Germany in return. In practice, Bulgaria financed Germany, receiving one billion marks of assets by the end of 1918, which, due to the depreciation of the German mark, were worth zero: thus the Bulgarian economy suffered higher losses than all the concluded foreign loans (Russenov (ed.) 1983).

During the war the exchange rate of the Bulgarian lev to the German mark was maintained by the BNB at 125 levs to 100 marks, and the depreciation of the lev and the mark did not affect the domestic market. A rationing system was introduced in Bulgaria for basic commodities. Inflation continued after the war, and the government debt to the BNB in 1918-1923 increased by five times (Russenov (ed.) 1983).

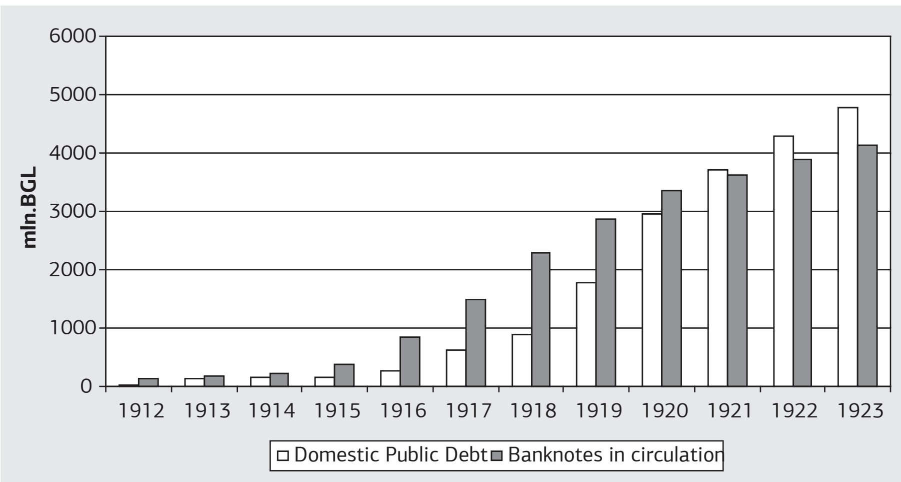
In 1916-1918 military expenditure was financed by the BNB and the budget deficit was 1.5 million gold levs, the banknotes in circulation increased by 14 times, and their holding was reduced to 3.2% of the gold and 5.9% of the silver levs. Between 1918 and 1922, before beginning to pay reparations, payments on the external debt reached 112 million gold francs. After the imposition of reparations and occupation debt (1919) the external debt reached 96% of public liabilities (Nenovsky and Andreev 2013)

Table 3 Banknotes in circulation, public debt, and gold reserve of Bulgaria (1912-1923) (Million levs)

Year	Banknotes in circulation	Public debt to BNB	Gold reserve	Assets abroad
1912	164,4	26,6	51,1	35,7
1913	188,7	142,9	55,3	13,8
1914	226,6	154,9	55,1	25,6
1915	369,8	146,9	61,4	253,2
1916	834,0	260,8	68,2	691,8
1917	1491,8	621,3	62,9	1239,8
1918	2298,6	881,3	64,0	1186,2
1919	2858,5	1771,3	87,0	1353,1
1920	3354,1	2964,3	37,1	1534,2
1921	3615,4	3702,3	38,0	1146,6
1922	3886,0	4130,4	38,4	764,6
1923	4139,0	4470,0	39,5	919,8

Source: (Russenov (ed.) 1983).History of Financial and Credit System of Bulgaria, vol. II, p. 508

Figure 2 Public debt and banknotes in circulation (1912–1923)



Source: Nenovsky and Andreev (2013), Bulgarian Economists on the Great Depression, Sofia

2. SECTORS OF THE BULGARIAN ECONOMY: AGRICULTURE AND INDUSTRY

2.1. Restructuring of agriculture

The duration of the First World War held back agricultural countries. Bulgaria was an agricultural country with inflexible farming that could not be transformed quickly, and its agricultural economy was dependent on weather conditions. Eighty per cent of total exports were agricultural products and raw materials and 70% of total imports were manufactured goods. The Bulgarian economy used more labour than capital, and 75% of the labour force was involved in the production of cereals. Agricultural production was more for subsistence than for the market, which did not create conditions for savings and capital accumulation (Popov 1919).

Before the 1912-1913 Balkan War, Bulgaria produced primarily grains. After the Treaty of Bucharest (1913) the country lost Dobrudzha, which was its granary and represented 7.8% of the country's territory and 6.5% of its population. Farms in Dobrudzha were large (in Bulgaria small farms of up to 100 decars predominated), technically well equipped (near Balchik there were 532 metal ploughs per 100 wooden ploughs[7], while in other part of the Bulgaria there were 27 metal ploughs per 100 wooden ploughs) and they produced for export. Losing Dobrudzha meant it was necessary to restructure the national economy from cereal production to tobacco (Popov 1919).

Grain production dropped during the war: in 1917 wheat production was 28% less than in 1912 (Mollov 1919). The worst crop was in 1918, when the yield was 1,304,622 tons from 22,807,946 hectares, 16.2% less than the weakest year before the wars, 1907, and 58.5% less than the best harvest in 1911. In 1918-1919 for the first time the cereals produced were insufficient to meet the country's consumption and sowing needs (N.M. 1919).

Table 4 Sown area and production of cereals in Bulgaria

Year	Sown area (hectares)	Production (tons)
1907	2,219,639	1,426,166
1911	2,523,738	2,876,305
1912	2,564,588	2,672,039
1917	2,099,021	1,861,001
1918	2,143,765	1,196,374

Source: Chronicle, Journal of the Bulgarian Economic Association, 1919, XIX. 1-2, p. 114

During the First World War Bulgaria was politically and economically dependent on Germany, supplying the German war economy with raw materials. Exports

[7] In Bulgaria the *ralo* (wooden plough) preceded the metal plough.

of cereals, tobacco, and other raw materials were directed to Germany, as Bulgaria did not have good transport links with the countries that had remained neutral. Bulgarian oriental tobacco, grown mainly in Aegean Thrace, was bought by German companies, which processed and exported it (Chakalov 1962).

Aegean Thrace was annexed to Bulgaria after the 1913 Treaty of Bucharest. The region was favourable for the production of high quality oriental tobacco and raised production and acquired a trademark for this type of tobacco. During the war the price of tobacco rose and Bulgaria delivered tobacco to the Central Powers. Until 1913 exported tobacco constituted 1.26% of total exports, which increased to 70.24% in 1917 and dropped to 55.46% after the loss of Aegean Thrace in 1920. In 1914 the value of exported tobacco increased; however, grains still represented 75% of total exports. The bad harvest in 1918-1919 reduced cereal exports, but the high tariffs imposed on tobacco by the Bulgarian state made it uncompetitive on the international market, as by the end of 1920 tobacco from the 1917, 1918, and 1918 harvests remained in the country (Duhovnikov 1921).

After signing of the Treaty of Neuilly (27.11.1911), when Bulgaria lost Aegean Thrace where oriental tobacco was grown, cereals again became the most cultivated crop in Bulgarian agriculture. Because of the loss of Dobrudzha in 1913, production of cereals decreased compared to the years before the Balkan wars.

2.2. Problems of Industry

Before the war, Bulgarian industry was underdeveloped, and larger enterprises enjoyed privileges under the Law on Local Industry Protection. About 15,000-16,000 people were employed in protected industries in 345 factories, and 73% of the raw materials were locally produced. The war put Bulgarian industry in a difficult situation, because as early as the beginning of the war the reserves of raw materials ran out, forcing some factories to reduce or cease operation. The state intervened by militarizing production for the army and requisitioning raw materials. It organized the production, collection, and importation of raw materials through the Committee and then the Directorate of Economic Care and Social Foresight. However, the devaluation of the lev and the restrictions on international trade also impeded the importation of raw materials and equipment after the war (Tsankov 1921).

Bulgaria, which had tried to industrialize after liberation from the Ottoman Empire, lost some of its small factories during the war. There was no capital to establish new industries, while the raw materials produced in the country were exported to Germany. Production facilities were destroyed, and their restoration was difficult, slow, and expensive, and in some industries impossible. After the war and the imposition of reparations the industry had to be demilitarized, which again hampered the existing industries and slowed down the country's industrialization process. The state organized the supply of raw materials and the realization of products and continued to protect larger companies[8].

3. PRICE REGULATION AND CHANGES IN FOREIGN TRADE

3.1. Price Regulation

The rise in the price of goods in Bulgaria resulted from the increase in banknotes in circulation, as not only their absolute value but also the rate at which they rose was extraordinary. At a base of 100 of the index of commodity prices for the period 1901-1910, the 1913 index showed a rise of 130, while in 1920 it was 2,399. The 1913 average market price had increased more than eighteen times by 1921 (Burilkov 1921).

The rise in food prices caused the state to regulate its consumption. War restructured production, changed distribution, and disturbed trade, which affected the warring countries, in particular poor countries like Bulgaria. In neutral countries and developed economies like the U.S.A. and UK the price increase was less (Mihaylov 1919).

Bulgaria had both regulated and market prices. The regulated prices were determined first by the Committee on Economic Care and then by the Directorate of Economic Care and Social Foresight, but they did not carry out actual transactions but only distributed and sold commodities to the public[9] (Tsankov 1921).

At the beginning of the war the state regulated the price of essential goods, which it bought from the farmers, and the price of other goods remained free. Farmers were forced to sell their produce at low regulated prices and buy other goods at high speculative prices (Mollov 1919).

3.2. Changes in Foreign Trade

During 1908-1914 Bulgaria's balance of trade was negative, as imports was greater than exports. During the war years the trade balance was positive, with higher exports than imports. Exports and imports decreased during the war, although their value rose due to the devaluation of the lev, the restrictions on international trade, and reduced production. After the war the trade balance was negative again, as a result of the country's free trade policy (Tsankov 1921).

During the war, Bulgaria's foreign trade was limited to its allies. Before the war the Ottoman Empire was Bulgaria's first trading partner, but during the war it was the last and Germany became the most important, followed by Austria-Hungary

8 The Law on Local Industry Protection was abandoned in 1936

9 Tsankov cites the regulated sugar price, which increased 125.2% compared to 1914, while the market price rose by 1251.3%.

and Switzerland. The country's exports to other countries were only worth 1,250 levs, the price of 25 kg of cigarettes (Tsankov 1919).

Before and during the war Bulgaria's exports were agricultural products, but because of the bad harvest of 1916-1918 the government prohibited the export of cereals. Raw tobacco became Bulgaria's most important export, representing 75% of the total. In 1911 the export of tobacco had been only 9.93% of total exports, but the restriction of Germany and Austria-Hungary's trade relations created an opportunity for Bulgaria to impose its tobacco on these countries. Besides tobacco, the export to the Central Powers of sheepskin, wool, and rose oil also increased (Tsankov 1919).

The structure of imports also changed. Before the war 75% of imports were fabrics, yarn, leather, machinery, sugar. The big countries' reduced industrial production for export restructured Bulgaria's imports, as now first place was taken by colonial goods: sugar, salt, chocolate, paper, etc., without significantly changing their ratio from that before the war. Before the war Bulgaria imported most goods from Austria-Hungary; during the war years the largest share of imports came from Germany and after the war from Austria-Hungary, Romania, and Turkey (Tsankov 1919).

4. THE ECONOMIC CONSEQUENCE OF THE PEACE TREATIES AND IMPOSED REPARATIONS

The economic development of Bulgaria in the 1920s depended on the peace treaties that ended the First World War. The Treaty of Neuilly (1919) imposed reparations on Bulgaria amounting to 2,250 million gold francs, payable for 37 years at 2% interest for the first year and 5% thereafter. Bulgaria's restitutions to Greece, Romania, and Yugoslavia included 37,825 cattle, 33,000 sheep, and 50,000 tons of coal for Yugoslavia. The reparations imposed on Bulgaria represented 22.5% of the national wealth before the war, and 55% of the state budget had to be allocated for their repayment. Before the payment of reparations was suspended in 1931[10] Bulgaria paid 270 million levs annually for reparations, 280 million levs for pre-war loans, and 680 million for post-war loans, or a total of 1,180 million levs, which was 32.8% of the estimated budget revenue. The country had problems maintaining the balance of payments, as revenues from export of agricultural products decreased due to their low prices on the world market. Revenues dropped from 500 million levs to 180 million levs per month (Nenovsky and Andreev 2013).

In 1923 Bulgaria reached an agreement with the Reparations Commission to divide the reparations into two parts, Part A to the amount of 550 million gold

[10] In 1931 Bulgarian reparations were postponed, initially for one year, and after continuous Bulgarian diplomacy they were cancelled in the 1930s, despite strong opposition from Greece.

francs, to be paid over 60 years with growing annuities, and Part B of 1,700 million gold levs, payable after April 1, 1953. Bulgaria could deduct receivables from part B (Russenov (ed.) 1983).

The economic crisis marking the onset of the Great Depression in late 1929 prevented countries from paying the reparations imposed after the First World War, and the creditor countries accepted relieving conditions for their debts. At the Hague Conference (Jan.3-20.1930), Bulgaria's average annual annuity payments were reduced from 12.5 million to 11 million gold francs, while England, France, and Italy waived outstanding contributions to Bulgarian occupation duty. A Bank for International Payments was established at the conference to facilitate the payment of reparations[11] (Bobchev 1930).

Bulgarian economists were united in the belief that the cause of the economic crisis of the 1920s and the Great Depression was the peace treaties of 1919, when reparations were imposed on the defeated countries with the aim of exhausting their economies and reducing their political influence. Payment of reparations forced the defeated countries to seek foreign currency by reducing imports and trying to increase exports. The consequences were autarchy, where countries seek to develop their own industries at high cost, with reduced competitiveness, low purchasing power of the national currency, a decline in demand and consumption, and economic crisis. The policy of the victorious countries of the First World War of enrichment at the expense of the defeated states could not be achieved in the economic sphere because the ruin of one country impacted the economies of other countries. (Nenovsky and Andreev 2013).

Post-war international conferences were held to try to restore the gold standard and balance the budgets of the European countries. The resolutions of the conferences in Brussels in 1920 and Genoa in 1922 restored the gold standard with international loans contracted through the League of Nations. The Geneva Conference of 1927 attempted to reduce the existing restrictions on international trade, as were united in the idea of concluding a "customs truce" so that tariffs would not be raised for a certain period of time, thus enabling foreign trade. It failed because it did not address the issue of reparations and the debts between the allies, which prevented the states from changing their customs policies (Bobchev 1930). Lengthy negotiations and another conference, again in Geneva in 1930, failed to reach consensus on the initial draft of the "customs truce", as it was agreed that the existing duties on commercial contracts should not be changed for a period of one year.

[11] The bank accepted the rights and obligations of the inter-allies Reparations Commission by collecting reparation payments from Bulgaria and transmitting them to the benefit of the countries victorious in WWI. Reparative obligations became political rather than commercial, and Bulgaria no longer had political reasons for the reduction of reparation obligations that were restructured in favour of Greece, Romania, and Yugoslavia.

The economic crisis of 1929 caused a decline in international trade, which affected both the defeated countries and the victors of the First World War, thus supporting the thesis that an upswing in the economy was only possible if a moratorium on reparative payments was imposed. In 1931 the U.S. President, Herbert Hoover, proposed a moratorium on payments, initially for one year, which was extended by six months and then remained until the Second World War when the political debts tacitly dropped off (Russenfov (ed.) 1983). The moratorium united 15 countries, but its adoption contributed little to economic recovery as the financial crisis was already a fact and it had become impossible for the defeated countries to repay their debts[12] (Nenovsky and Andreev 2013).

CONCLUSION

Before the First World War Bulgaria was an agricultural country growing extensive crops and trying to export them to international markets. Many people were employed in agriculture, the farms were small and the production was mainly for subsistence. The sector was influenced by weather conditions (hail, drought, etc.), returns were decreasing, and many times a good harvest in one year offset past losses. The wars in which the country was involved changed its territory, which also restructured its agriculture. The high price of tobacco during the First World War made it the preferred crop of Bulgarian farmers and despite the loss of territories suitable for its cultivation it remained the leading Bulgarian agricultural product and export after the war as well. The mobilization of the working population and the loss of people, livestock, and farm equipment decreased the productivity of Bulgarian agriculture, and at the end of the First World War even flour had to be imported to feed the population.

Bulgarian industry prior to the war was underdeveloped and lacking capital; production capacity was small and profitability was low. The state tried to encourage industry by ensuring privileges for some enterprises. The First World War destroyed the small factories that could not adapt to military production, while the existence of the rest was only possible with the assistance of the state, which supplied the required raw materials and realized their production. The peace treaties and the war reparations slowed down industrialization and Bulgaria remained an agricultural country with most of its population employed in agriculture.

The Bulgarian government financed the participation of Bulgaria in the war through external loans from its allies and domestic loans through the BNB. The increase of banknotes in circulation during the war years was enormous, causing inflation that continued after the war until the formal stabilization of the Bulgar-

[12] At the Lausanne Conference, held in 1932, the victorious countries signed a moratorium suspending reparative payments from the defeated countries.

ian lev in 1924. The war proved that the state could issue money without holding gold, but a return to the gold standard was required to restore the stability of the national currency. The instability of the exchange rate of the Bulgarian lev on the international market created preconditions for the BNB's monopoly of determining the foreign exchange rate, a privilege that it would also retain after the war.

The imposed reparations on Bulgaria hampered its economic recovery. They reduced the solvency of the country after the First World War (1914-1918), causing a deficit in the balance of payments. The structure of the Bulgarian economy was such that much of the national income was in kind, as the only monetary income was used to meet the financial needs of the state and for the payment of public loans and reparations. However, Bulgaria continued to pay the reparations until their termination during the Great Depression.

REFERENCES:

Bobchev, K. (1930), "International Conference on Customs Truce", *Journal of the Bulgarian Economic Association*, XXIX.1, pp. 51-56.

Burilkov, G. (1921), "The Increase of Banknotes and its Impact on Prices and Currency", *Journal of the Bulgarian Economic Association*, XX.1-2-3, pp. 119- 125.

Chakalov, As. (1962), *Forms, Size and Activity of Foreign Capital in Bulgaria (1919 – 1944)*, Sofia.

Duhovnikov, D. (1921), "Tobacco in our National Economy, Trade Balance and Government Finance", *Journal of the Bulgarian Economic Association*, XX, 6-7, pp. 188-214.

Hristoforov, As. (2010), *Selected Works, vol. I*, Edition BNB, Sofia.

Kolev, K. (1919), "Monetary Circulation during the War", *Journal of the Bulgarian Economic Association*, XIX.1-2. pp. 15-34.

Lyapchev, A. (1919), "The War and Finance", *Journal of the Bulgarian Economic Association*, XIX. 1-2, pp. 1-14.

Mihaylov, N. (1919), "Rising Cost of Living in some European Countries during the War", *Journal of the Bulgarian Economic Association*, XIX. 1-2-3, pp. 255-261.

Mollov J. (1919), "Agricultural Production and the War", *Journal of the Bulgarian Economic Association,* XIX.1-2, pp. 53-69.

Nenovsky, N. and Andreev, R. (2013), *The Bulgarian Economists on the Great Depression*, University edition, Sofia.

N. M. (1919), "Chronicle", *Journal of the Bulgarian Economic Association*, XIX. 1-2, pp 114-115.

Popov, K. (1919), "Economic Bulgaria and the Financial and Economic Clauses of the Draft Peace Treaty", *Journal of the Bulgarian Economic Association*, XIX.3-4-5, pp. 129-175.

Russenov, M. (ed.) (1983), *History of the Financial and Credit System of Bulgaria, volume* II , Edition Georgy Bakalov, Varna.

Todorov, P. (1921), "About Government Finance", *Journal of the Bulgarian Economic Association* , XX.4-5, pp. 1-22.

Tsankov, Al. (1921), "Bulgaria during the War and Afterwards", *Journal of the Bulgarian Economic Association*, XX, 1-2-3, pp. 36-55.

Tsankov, Al. (1919), "Our Foreign Trade in 1917", *Journal of the Bulgarian Economic Association*, XIX.1-2, pp. 71-90.

Chapter 14

The Causes and Consequences of the Customs War Between Serbia and Austria-Hungary, 1906-1911

Radovan Kovačević*
E-mail: radovank@ekof.bg.ac.rs

Abstract: At the end of the 19th century Serbia's foreign trade was characterized by heavy dependence on Austria-Hungary. Trade agreements concluded between Serbia and Austria-Hungary in 1881 and 1892 prevented the independent development of Serbia. External debts were serviced by exporting agricultural products as raw materials to the markets of the Austro-Hungarian Empire. The trade agreements maintained the existing structure of Serbian production and exports by imposing low tariffs on manufactured products imported from the Austro-Hungarian Empire, which impeded the development of domestic industry, and low tariff rates on the export of agricultural products in cross-border trade, by which Austria-Hungary intended strengthening Serbia's dependence on its markets. Thus the trade agreements protected the Austro-Hungarian Empire's industrial exports from competition in the Serbian market and succeeded in making Serbia export only raw materials and import refined products. The Austro-Hungarian Empire wanted to prevent Serbia's industrial development because it was easier to integrate an underdeveloped Serbian economy that produced raw goods. In an effort to provide more favourable conditions for foreign trade, Serbia signed an agreement with Bulgaria in 1905 that abolished customs and other duties in mutual trade. Austria-Hungary immediately asked Serbia to provide the same conditions for its products, or to withdraw from the customs union with Bulgaria. Although the Serbian government demonstrated a willingness to revise the terms of the agreement with Bulgaria, Austria-Hungary was not satisfied and at the end of June 1906 banned the import and transport of livestock and all cereals through its territory. This led to a drop in Serbian exports of almost 80%. Austria-Hungary wanted to prevent the connection of the Balkan states. Serbia started a regional reorientation of its exports in 1906 when it discovered that in the period 1898-1905 the Austro-Hungarian Empire had received around 52% of Serbia's exports, but only 48% had remained in its market. This finding strengthened the commitment of Serbia to redirect exports to other countries. As a result, Serbia was able to increase the value of its exports in the coming years by concluding trade agreements with other countries. In 1911 it made a new trade agreement with Austria-Hungary, after which only 18% of Serbia's total exports went to Austria-Hungary, and only 19% of its total imports came from Austria-Hungary. The reduction in Serbia's foreign trade with the Austro-Hungarian Empire was not welcomed in Vienna, and in the succeeding years the Austro-Hungarian Empire used various means to try to interfere with the independent development of Serbia.

Key words: AustrIA-Hungary, Serbia, exports, imports, customs war

JEL Classification: B31, N73, F14, F18

* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179065) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia

INTRODUCTION

The development of economic and political relations between Serbia and Austria-Hungary in the 19th century led to the customs (or pig) war. Aggressive Austro-Hungarian imperialism sought to conquer the Balkan countries by tying their economies to its market and by political pressure. Austro-Hungarian agricultural protectionism had limited Serbian exports to other Balkan countries. In an effort to gain economic independence from the Austro-Hungarian Empire, Serbia tried to make an alliance with the other Balkan countries. Since the bulk of Serbia's exports went to the Austro-Hungarian market, constraints on exporting and transporting Serbian products across Austro-Hungarian territory damaged Serbia's economy. Two trade agreements between Serbia and the Austro-Hungarian Empire (1881 and 1892) prevented the development of Serbian industry, so Serbian exports were dominated by agricultural and livestock products. The economic dependence on the Austro-Hungarian market was a major impediment to the development of independent Serbia in the 19th century. At the beginning of the 20th century Serbia tried to export to emerging markets. In order to prevent the economic and political independence of Serbia, the Austro-Hungarian Empire began a tariff war in 1906, closing its borders to Serbian exports and transport of Serbian products. The tariff war had several phases and lasted until the conclusion of a new trade agreement in 1911.

This paper consists of three parts. The first part analyses the significance of the Austro-Hungarian Empire to the economy of the Kingdom of Serbia, the second section deals with the tariff war between Austria-Hungary and Serbia in 1906-1911, and the third section explores the economic consequences of the customs war.

1. THE IMPORTANCE OF THE AUSTRO-HUNGARIAN MARKET TO THE ECONOMY OF THE KINGDOM OF SERBIA

As it gradually emerged from the shadows of the Ottoman Empire, Serbia focused on expanding its economic cooperation with the Austro-Hungarian Empire, particularly after Serbia gained its independence, which was confirmed by the Congress of Berlin in 1878. The Austro-Hungarian share in the foreign trade of the Kingdom of Serbia is shown in Table 1.

Table 1. Austro-Hungarian share in Foreign Trade of the Kingdom of Serbia from 1886 to 1908 (in %)

	Exports	Imports
1886	78	72
1887	89	75
1888	87	67
1889	79	65
1890	86	60
1891	69	61
1892	88	59
1893	89	58
1894	89	59
1895	89	59
1896	88	58
1897	88	56
1898	90	56
1899	83	59
1900	85	47
1901	85	53
1902	80	56
1903	86	61
1904	89	60
1905	90	60
1906	42	50
1907	16	36
1908	28	43

Source: Pertot, V. (1970), p. 5.

After gaining independence Serbia committed to regulating trade with Austria-Hungary by a new trade agreement. However, in the period up to the signing of the new contract Serbia had to comply with the provisions of the 1862 trade agreement between Austria-Hungary and Turkey, which allowed the Austro-Hungarian Empire to determine the level of customs duties on imports from Serbia, while Serbia could only impose a maximum tariff rate of 3% on imports from the Austro-Hungarian Empire. Austria had established these low tariffs for their exports to the Balkan area in the Karlova**čki** peace treaty in 1699, while the Austro-Hungarian Monarchy maintained the conditions in trade agreements signed later with Turkey.[1]

The majority of Serbia's exports were agricultural and livestock products, partly due to the proximity of Austro-Hungary markets. Meanwhile the Austro-Hungarian Empire was a major exporter of manufactured products, not only to Serbia but also to other Balkan countries. As the Austro-Hungarian Empire was less developed

[1] Bajkić, V. (1902), pp. 7-9.

than other Western European capitalist countries it exported its higher-quality agricultural products to the west and imported lower-quality agricultural products from Serbia and other Balkan countries, while exporting its industrial products to the Balkan markets. Austro-Hungarian merchant capital became an intermediary in the trade with Serbia and thus had an interest in maintaining the existing structure of production in the Balkan countries.

Serbia signed its first trade agreement with the Austro-Hungary Monarchy in 1881, for a period of 10 years. This agreement included some provision for cross-border transactions that gave preferential treatment to Serbian agricultural products in the 'most-favoured nation' clause. In turn, Serbia reduced tariffs on the importation of certain industrial products from the Austro-Hungarian Empire. The result of these concessions was the protection of Serbian exports from Austro-Hungarian competition while protecting Austro-Hungarian industrial products from foreign competition in the Serbian market. These mutual concessions in customs tariffs enabled Austria-Hungary's goal of preventing Serbia from developing its industry and maintaining it as a supplier of raw material for the Austro-Hungarian market,[2] as part of a long-term strategy to integrate Serbia and other Balkan countries into Austro-Hungarian space as undeveloped areas.

Serbia also signed a Veterinary Convention with the Austro-Hungarian Empire, which allowed the Empire to ban not only imports but also the transportation of cattle that the medical authorities suspected of being infected. Austria-Hungary would later often use this provision to put pressure on Serbia (e.g., in 1882 the border with Serbia was closed because of infection in one district). Occasional bans on the export of livestock from Serbia significantly reduced export revenues, leading to a trade deficit with Austria-Hungary. The disequilibrium in Serbia's foreign trade during the 1880s can be seen in Table 2.

Table 2. Foreign trade of Serbia in the period 1879-1883(in thousand dinars)

	1879	1880	1881	1882	1883
Import					
From Austria-Hungary	35,929.5	41,811.8	38,725.6	44,649.1	45,613.2
Total import*	41,567.6	46,095.6	43,173.8	48,451.3	49,716.6
Export					
To Austria-Hungary	23,167.9	26,781.9	32,991.7	34,143.8	5,695.0
Total export*	38,880.8	35,212.3	40,127.1	40,334.1	40,232.5
Balance					
with Austria-Hungary	-12,761.6	-15,029.9	-5,733.9	-10,505.3	-9,918.2
Total trade*	-2,686.8	-10,883.3	-3,046.7	-8,117.2	-9,484.1

* Apart from the Austro-Hungarian Empire, Serbia traded with Bosnia, Bulgaria, Romania and Turkey.
Primary source: Ministarstvo finansija (1884). Secondary source: Gnjatović, D. (1991), p. 39.

[2] For any import of livestock from Serbia to Austria-Hungary the exporter had to pay a customs duty of 4 florins, and customs duties on imports from Germany were 12.75 florins. Meanwhile, 51% of Austro-Hungarian imports into Serbia was exempt from duty (Đorđević, D. (1962), p.16).

The 1881trade agreement between Serbia and Austria-Hungary prevented structural changes in Serbian exports. The export of live cattle was very important, while imports were dominated by processed products. An additional problem for Serbia was accumulated debts to the Austro-Hungarian Empire. Because of this, neither of the new trade agreements signed with the Austro-Hungarian Empire in 1892 allowed Serbia to develop independently: to regularly repay its debts, Serbia was forced to increase livestock and agricultural product exports, stimulated by favourable tariffs for cross-border trade. Transportation costs were lowest for exports to the Austro-Hungarian Empire. Shorter transport was particularly significant in the export of live animals, which was why the Austro-Hungarian market played a special role in Serbian exports.

In 1905, on the eve of the customs war, 89.8% of total Serbian exports went to the Austro-Hungarian market, or 98% of total Serbian livestock exports. This illustrates the high degree of economic, and thus political, dependence of Serbia on Austria-Hungary. In an effort to gain independence from the Austro-Hungarian Empire, in 1895 Serbia tried to export cattle to Italy, Marseille, and Thessaloniki, but failed due to transportation problems. The Belgrade Slaughterhouse Society was founded in 1897 in order to facilitate the export of livestock meat. This was the first step in the development of the Serbian meat processing industry. At the end of the 19th and in the early 20th century Serbia was aware that it had to liberate itself from the Austro-Hungarian Empire, and so it was looking for other European outlets for agricultural and livestock products in order to reduce its trade dependence.

2. THE CUSTOMS WAR BETWEEN AUSTRIA-HUNGARY AND SERBIA, 1906-1911

At the beginning of the 20th century agricultural protection in Europe increased. Germany increased tariffs on wheat imports by two to five times in 1902, opting for strong agricultural protectionism[3]. The Austro-Hungarian Empire followed, threatening grain imports from the Balkan countries. The 1905 trade agreement between Germany and Austria-Hungary introduced limitations on free trade. Taxes were introduced on the import of pigs to Germany from the Austro-Hungarian Empire (which had been tax-free), and the export of meat to the German market was regionally restricted. The agreement restricted the free movement of livestock, which affected the export of livestock from Serbia to Austria-Hungary. This can be seen in Table 3.

[3] Vujić, M. (1903), pp. 170-171. See Đorđević, D. (1962), p. 95.

Table 3. Export of cattle from Austria-Hungary to Germany and from Serbia to Austria-Hungary

	1902	1903	1904	1905
The share of Germany in Austro-Hungarian cattle exports, in %	89.44	92.15	91.25	93.21
The share of Serbia in Austro-Hungarian cattle imports, in %	96.99	92.26	91.23	79.67

Source: Đorđević, D. (1962), p. 96.

Strengthening agricultural protectionism in Europe increased the crisis within the Austro-Hungarian Empire. From 1902 the Hungarian struggle for independence grew stronger; Hungary demanded a ban on imports of agricultural raw materials, which further restricted free trade between Serbia and Austria-Hungary, and thereby contributed to the economic independence of Serbia from the Austro-Hungarian Empire. Hungary's requirements in terms of agricultural protection became one of the major obstacles to the conclusion of a new trade agreement between Serbia and Austria-Hungary. The extraordinary growth of agricultural protection in Germany and Austria-Hungary imposed strong constraints on Serbian agricultural exports, which lead to the outbreak of the customs war. Serbia concluded a trade agreement with Germany in 1904, but this agreement allowed neither the export of live cattle nor the free export of fresh meat to the German market. It did allow Serbia to export processed meat to the German market and to transport slaughtered livestock and meat through Germany to other markets. This agreement with Germany came into force on 1 March 1906, and it became obvious that Serbia could fall into a non-treaty state with Austria-Hungary. In the spring of 1905 Serbia began intensive negotiations with Turkey for a new trade agreement. The abolition of transit fees was very important to Serbia due to the importance of traffic through Thessaloniki. This agreement entered into force on 14 September 1906. It was very important for Serbia not to lose out in the south at a time when the customs war had erupted.

In an effort to defend itsef against pressure from Austria-Hungary, Serbia took the initiative to form an alliance of Balkan states. This initiative was directed towards Montenegro and Bulgaria, and talks with Bulgaria led to the signing of an agreement on the abolition of customs duties in bilateral trade. Although the Serbian government agreed to start negotiations with Bulgaria before entering into a trade agreement with Austria-Hungary, it had reservations about the idea of a customs union with Bulgaria, but was interested in concluding a customs alliance with a common economic area. Under this agreement both countries would retain separate customs tariffs with abroad, as well as separate trade agreements with other countries. The Common Customs Tariff was to come into force in 1917. According to the signed contract, only local products were spared the payment of customs duties in bilateral trade[4]. Although the Serbian goverment had some reservations about the agreement, on 2 January 1906 the National Assembly in Sofia voted for the customs alliance with Serbia. Bulgaria was in a hurry to announce the conclusion of the contract before it started negotiations in Vienna to sign a new contract with Austria-Hungary, and could not expect to get concessions like Serbia. As soon as this contract between Serbia and Bulgaria became known in Vienna, Austria-Hungary asked for negotiations with Serbia to be suspended. Although the Serbian government submitted this contract to Vienna, stating that it would not submit it to the Assembly for adoption until a new trade agreement with Austria-Hungary had been signed, trade negotiations were not resumed, with the demand that Serbia abandon its contract with Bulgaria. Serbia felt this demand restricted its international legal sovereignty. In fact the Austro-Hungarian Empire was more bothered by the political than by the economic association of Balkan countries, and tried to prevent it. This policy was wholeheartedly supported by the military.

On 22 January 1906 Austria-Hungary began a blockade of the Serbian border, with the excuse that it was to prevent transmission of infection. Although it had already been clear at the end of 1905 that Austrian agricultural protection would prevent the conclusion of a new agreement, Serbia had not expected such an extreme response from Vienna. Austria-Hungary embargoed further exports from Serbia, returned merchandise that had already been sent across the border, banned the import of Serbian beef, and banned the transport of exports through its territory, in violation of the trade agreement that was to expire on 1 March 1906. In Serbia this was seen as a political conflict. Serbia left the customs alliance with Bulgaria and Austro-Serbian negotiations resumed in Vienna in mid-March 1906. Negotiations continued until 1 June 1906, in the hope of reaching an agreement. The modus vivendi that existed until 1 June 1906 was not explicitly extended, but nor was it suspended, so the previous trade practice continued on a case-by-case basis. Although there were still difficulties, retailers rapidly exported cattle and pigs from Serbia.

Serbian government procurement, primarily of cannons and artillery equipment, was an additional reason for the outbreak of the customs of war, which began on July 7 1906 when the Austro-Hungarian Empire issued an order to all customs offices banning the import and transit of all types of livestock and meat from Serbia[5]. In response the Serbian government ordered the implementation of a general customs tariff on Austro-Hungarian products.[6] In Vienna it was be-

[4] Đorđević, D. (1962), p. 125.

[5] In October 1906 the Austro-Hungarian Empire even banned a transport of crates of meat submitted as an exhibit to an exhibition in Milan. In early 1907 it prevented transport of a 5 kg package of salami, sent to an exhibition in Bordeaux (Đorđević 1962, p.293).

[6] "It was apparently belived that this conflict, like many earlier ones with Serbia, would lead to no futher complications" (Neurath 2004, p.2009).

lieved that Serbia would not be able to withstand the economic pressure and would soon seek a resumption of negotiations, accepting Austro-Hungarian demands. The Austro-Hungarian Empire wanted to crush Serbian independence and break its resistance. They had expected that the dependence of Serbian exports on the Austro-Hungarian market would achieve the Monarchy's political goals, because the Empire was a consumer of and intermediary for Serbian products. In the period 1894-1905 Austria-Hungary consumed 305.971 million dinars worth of food imported from Serbia, and earned 323.864 million dinars as a mediator[7]. Because of Serbia's dependence on the Austro-Hungarian market, the Monarchy was convinced that closing the border would be a serious blow to Serbian exports, and thus to the country as a whole.

After the outbreak of the customs war, Serbia decided to procure its artillery in France (the so-called "cannon question"), using a French loan as payment[8]. Thus Serbia avoided purchasing weapons from Austria-Hungary, the country which threatened it. Trade negotiations with Austria-Hungary continued, and Serbia tried to find a replacement for the Austro-Hungarian market

3. THE ECONOMIC CONSEQUENCES OF THE CUSTOM WAR

Serbia rushed to find new markets to replace the Austro-Hungarian market. At the same time it had to provide inexpensive transportation to the new markets, and had to be competitive in price and quality. To overcome these difficulties Serbia decided to establish a new foreign trade network. Commercial capital alone could not solve all these problems, so help from the state was necessary. The main Serbian exports were cereals, fruit, cattle, and pigs. Cereals would be most profitable in markets where there was no duty on it: Belgium, the Netherlands, and England. Although these markets were far from Serbia the increased transportation costs would be offset by the absence of tariffs. Unlike cereals, which were not affected by the length of transport, the export of cattle and pigs was focused on the closer, Mediterranean countries: Egypt, Italy, and Malta. Although Egypt was a significant importer of live cattle it imported exclusively via Alexandria, which significantly decreased opportunities for Serbian exports. The Italian market provided opportunities for Serbian livestock exports, and there were significant opportunities to export meat to the English market. The French market was also interested in exports from Serbia. For these new markets it was important to ensure reliable transport[9].

---

[7] Stojanović, K. (1911), p. 30. According to Ćorović, V. (1992), p. 105.

[8] The loan was signed in November 1906 to the nominal amount of 95 million dinars. Its effective amount was 81.7 million. 46 million was earmarked for military purposes, and 35 million for the railway. The loan had a term of 50 years. Although the loan did not specify that military equipment was to be purchased in France, the Serbian government had already decided to buy French Schneider guns (for the details of the loan, see Nedeljković 1909, pp.277-281)).

[9] Đorđević, D. (1962), p.302.

In order to facilitate trade, Serbia signed trade agreements with Germany, Russia, France, Italy, Switzerland, Belgium, Romania, and England, and legitimized existing contracts with Turkey and Montenegro. Thanks to these agreements, Serbia had a new geographical distribution for its exports and imports, and had increased foreign trade. The knowledge that in 1898-1905 the Austro-Hungarian Empire shifted 52% of total imports from Serbia abroad while 48% remained in its market spurred the focus on these new markets. Thanks to the regional reorientation of exports using the new railway and maritime and inland waterways, in 1906 the Austro-Hungarian share in total Serbian exports was reduced to 42% and its share in Serbia's merchandise imports was reduced from 60% to 50%[10].

Reduced export of cattle and pigs from Serbia in 1906 was covered by increased export of grain to Belgium, the Netherlands, France, Italy, and Germany via the Danube through Varna and Thessaloniki. The refunds for transportation received by the Bulgarian and Turkish Railways contributed to the increase value of exports.

The importance of export credits was stressed in the customs war. Before the outbreak of the war the Austro-Hungarian Empire had generally financed Serbian livestock exports. Although the terms of these loans were unfavourable, they were more favourable than loans that could be obtained in Serbia.

The most important consequence of the customs war was a regional redirection of Serbia's foreign trade, with a pronounced reduction of dependence on the Austro-Hungarian market (Table 4). The share of the Austro-Hungarian Empire in Serbian exports decreased to 42% in 1906 while Germany's share increased from 3% in 1905 to 27% in 1906. Particularly noteworthy is the fact that the share of Austria-Hungary in Serbia exports declined to 16% in 1907.

Table 4. Share of individual countries in Serbian exports before and during the customs war (in %)

	Austro-Hungary	Belgium	Italy	Germany	Turkey	Other countries
1901	85	-	-	6	3	6
1902	80	4	-	8	2	6
1903	86	1	-	5	4	4
1904	89	-	-	4	3	4
1905	90	-	-	3	3	4
1906	42	9	1	27	8	13
1907	16	16	6	40	5	17
1908	28	21	4	18	14	15
1909	31	11	3	17	24	14
1910	18	16	1	22	24	19

Note: This data on exports by country should be taken with caution since goods sent to Western countries were often declared as exports to Romania, and goods transported via Thessaloniki as exports to Turkey (according to Đorđević, D. (1962), p. 384).
Source: Todorović, M. (1911), p. 77.

[10] Gnjatović, D. (1991), pp.91-92.

Due to the increase in cereal exports, which offset the decline in livestock exports, total Serbian exports in 1906 were slightly lower than in 1905. Reduced Serbian dependence on the Austro-Hungarian Empire after 1905 contributed to a significantly higher growth in exports compared to previous years (Table 5). This can be seen by the fact that exports increased from 72 million dinars in 1905 to 98 million dinars in 1910. Also, a continuing upward trend in exports can be observed, with the exception of 1908.

Table 5. The value of Serbian exports for five contractual years (1901-1905) and five non-contractual years (1906-1910), in dinars

1901	65,685,653
1902	72,123,654
1903	59,967,404
1904	62,156,066
1905	71,996,274
1906	71,604,078
1907	81,491,262
1908	77,749,078
1909	92,981,755
1910	98,388,028

Source: Todorović, M. (1911), p. 77.

There is also a noticeable shift in the structure of exports. In contrast to the situation before the outbreak of the customs war when Serbia exported three items (animals, fruit, and grains), after 1905, although these three items continued to be crucially important, ores and metals, flour, hemp, wood, and coal were also exported. The shares of principal products in total exports changed significantly: livestock exports declined and the export of livestock products and grain and fruit increased[11].

The sensitivity of exports to changes in demand for certain products was reduced by the increase in export supply. A supply of diverse exports to an increased number of markets also mitigated the consequences of cyclical movements in demand in certain markets. The quality of export products from Serbia also improved, in accordance with the requirements of the new markets.

It is not necessary to emphasize the benefits of export diversification to more countries. Serbia's earlier dependence on exports to the Austro-Hungarian Empire had often faced the country with a fait accompli to accept certain requirements that usually had nothing to do with trade, because otherwise it faced closure of the border to exports. Previously, the dynamics of Serbian exports had only been coor-

[11] Todorović, M. (1911), p. 767.

dinated with the Austro-Hungarian market[12]. The non-contractual situation with the Austro-Hungarian Empire lasted, with brief interruptions, until late in 1910.

The customs war opened opportunities for foreign capital to enter the country. Concessions were given to German capital to build a sugar factory in Belgrade. French capital held the strongest position in the Serbian market, primarily through the government loans that Serbia used for military orders. French finance capital showed a growing interest in Serbia, primarily in mining, and particularly in the Bor mines. English capital was also interested in mining. German capital penetrated Serbia through trade and capital loans. During 1910 foreign capital entered the country as Serbian government loans, but did not show much interest in financial operations in the country because of the risk.

The customs war contributed to the centralization of Serbian trade, which had previously been divided with individually small amounts of working capital. The earlier mediating role of Austro-Hungarian capital in Serbian trade was taken over by domestic capital. "Concentrating export trade in experienced hands, which are strong in capital, is the largest gain since the closure of the border" could be read in the Commercial Gazette[13]. Before the outbreak of the customs war there were a large number of small exporters in Serbia: that changed because larger amounts of capital were provided for organized trade in distant markets. A similar process of centralization can be observed in imports. The Capital Export Bank, which was established in 1901, became owned by big importers during the customs war.

The economic emancipation of Serbia during the customs war encouraged the Austro-Hungarian Empire to annexe Bosnia and Herzegovina in 1908. The Austro-Hungarian Empire's aim was to take complete control of the Western Balkans and get compensation for the economic losses inflicted by the customs war. The annexation further increased the customs war, with a full financial and commercial blockade of Serbia by the Austro-Hungarian Empire. Tensions between Serbia and Austria-Hungary were exacerbated by the annexation of Bosnia and Herzegovina, so that at the end of October 1908 the outbreak of war seemed inevitable. Serbia's war preparations and military expenditure and the Austro-Hungarian financial blockade precipitated a financial crisis in Serbia. The Serbian population flocked to the counters of financial institutions to withdraw their money, and Austro-Hungarian lenders rushed to settle their claims. Imports came to a halt and export trade was significantly reduced. Austria-Hungary imposed a military blockade on Serbia, prohibiting the transport of war materials. Artillery weapons from France were delivered via Thessaloniki. Despite all this, talks aimed at signing a new trade agreement were resumed.

[12] For the dynamics of economic activity in the Austro-Hungarian Empire, see Ciccarelli, C. Anna Missiaia, A. (2014).

[13] Trgovinski glasnik (1907). According to Đorđević, D. (1962), p. 648.

The trade agreement concluded in 1910 reflected the new relations between Serbia and the Habsburg Monarchy[14]. The goal of Serbia in this agreement was to gain direct connections with Western Europe countries, not to win back the Austro-Hungarian market. The main limitation of the 1910 contract was the prohibition of the transit of livestock. The contract reduced relations between Serbia and Austria-Hungary to an all-time low. Regardless of the consequences of the economic blockade, Serbia's trade balance was in surplus for the entire duration of the customs war. A review of Serbia's foreign trade is given in Table 6.

Table 6. Serbian foreign trade for the period 1906-1910 (in dinars)

	Export	Import	Transit	Turnover
1906	71,604,098	44,328,642	48,645,925	164,578,665
1907	81,491,262	70,583,327	55,963,728	208,038,317
1908	77,749,078	75,635,417	46,511,481	199,895,976
1909	92,981,755	73,535,086	49,998,082	216,514,923
1910	98,388,028	84,695,641	57,764,890	240,848,559

Source: Đorđević, D. (1962), p. 640.

The trade results enabled Serbia to overcome the economic crisis, which opened space to complete their economic emancipation from Austria-Hungary. It had a decisive influence on the subsequent economic development of Serbia, as well as on its foreign policy, which would lead to the Balkan Wars in 1912-1913. Instead of economically weakening Serbia, the customs war contributed to its independence and strengthened its position internationally. Economic pressure from Vienna proved to be a failed policy, and, as pointed out by Vladimir Ćorovic, revealed that in Serbia there were "... certain forces which should not be underestimated and that, therefore, should be suffocated before they become dangerous"[15]. Serbia would soon feel the consequences, because the Austro-Hungarian Empire was looking for a military opportunity to prevent it becoming stronger and more independent. The opportunity came in 1914, when Austria-Hungary declared war on Serbia, and the Great War (World War I) began.

[14] The Serbian parliament adopted a trade agreement with Austria-Hungary in principle on 17-30 November 1910. Due to delays in the Hungarian Parliament, the Serbian government postponed the final adoption of the Treaty, but it was considered as if it were accepted. The Hungarian parliament voted on the contract on 10 January 1911. The Treaty was finally ratified in Belgrade on 23 January 2011, and entered into force on 24 January 2011. ((Đorđević, D. (1962), pp. 624-626)).

[15] Ćorović, V. (1992), p. 107.

CONCLUSION

The customs war between Serbia and Austria-Hungary which lasted from 1906 to 1911, had both economic and political causes, and significant consequences for Serbia. Serbia's attempts at economic and political independence conflicted with Austria-Hungary's intentions to submit the Balkan country to its imperial will. Therefore, a crisis in their relationship was inevitable. The Austro-Hungarian policy of agrarian protection, which closed the border to Serbian exports in 1906, played a large role in Serbia becoming economically independent. This trend coincided with the desire of domestic commercial capital to no longer share the domestic market with Austro-Hungarian capital. The Austro-Hungarian Empire tried to dominate Serbian trade through commercial capital and the fact that a large share of Serbia's exports were directed to the market of the Danube Monarchy. Increasing agrarian protectionism, which Hungary insisted on, decreased the economic supremacy of the Austro-Hungarian Empire in Serbia, leading to harsh political measures in order to continue imperial Hapsburg policies. Thus the causes of the customs war were both economic and political. The Habsburg Empire's permanent economic and political pressure on the Balkan countries led to the idea of these countries connecting. The independence of the Balkan countries was a major threat to the realization of the Habsburg Monarchy's expansionist aims. Together, these reasons contributed to the outbreak of the customs war in 1906. A paper Serbo-Bulgarian customs alliance caused a powerful Austro-Hungarian answer, so Serbia had to find economic routes to the south, across Turkish territory to Thessaloniki, in order to avoid economic disaster. In 1906 Serbia tried to avoid conflict with the Monarchy at all costs because it feared the economic consequences of the closure of the Austria-Hungary border to Serbian exports. Although the customs war passed through several phases, by 1907-1908 Serbia had managed to overcome the economic crisis and neutralize the economic consequences of the border blockade by redirecting its exports to new markets. The Hapsburg Monarchy then imposed political pressure by prohibiting the transport of military equipment from France to Serbia across its territory. Tensions became heated with the annexation of Bosnia and Herzegovina. After the peak of the conflict in 1907-1908 there came a certain calm. At the end of the customs war the political reasones were more important for Serbia than the economic need to sign the 1910 trade agreements, while for Austria-Hungary this contract had economic significance. The economic and political independence of Serbia from the Austro-Hungarian Empire was the result of the customs war. During the customs war Serbian exporters found new routes to new markets, the quality of export products improved, and export structure substantially changed. The process of geographic redirection of trade was accompanied by penetration of the Serbian market by German commercial and French financial capital, and suppression of Austro-Hungarian commercial capital. Although foreign capital played a significant role in the initial stages of Serbian industrialization, Serbian state loans meant dependence on European, primarily French, financial capital. The unchanged traditional structure of agricultural production in Serbia, which was due to the Austro-Hungarian demand for raw material imports, had been forced to seek new markets. The government encouraged the provision of new export markets by incentives and organization of foreign trade. This was followed by enlargement of trade capital in response to the need to increase working capital for the realization of exports and to cover trade risks. The internal market was mastered by importers with large amounts of capital, whose economic power increased by suppressing competition from Austro-Hungarian capital.

REFERENCES

Bajkić, V. (1902), *Istorija srpske trgovinske politike*, I, Belgrade.

Ciccarelli, C. and Missiaia, A. (2014), *Business fluctuations in Imperial Austria's regions, 1867-1913: new evidence*, Economic History Working Papers No. 186, The London School of Economics and Political Science, London.

Ćorović, V. (1992), *Odnosi između Srbije i Austro-Ugarske u XX veku*, Biblioteka grada Beograda, Special edition 8, Belgrade.

Đorđević, D. (1962), *Carinski rat Austro-Ugarske i Srbije, 1906-1911*, Istorijski institut, Belgrade.

Gnjatović, D. (1991), *Stari državni dugovi: Prilog ekonomskoj i političkoj istoriji Srbije i Jugoslavije 1862-1941*, Ekonomski institut i Jugoslovenski pregled, Belgrade.

Ministarstvo finansija (1884), *Pregled spoljne trgovine Kraljevine Srbije 1879-83*, Kraljevsko-srpska državna štamparija, Belgrade.

Nedeljković, M. (1909), *Istorija srpskih državnih dugova*, Belgrade.

Neurath, O. (2004), *Economic Writings, Selections 1904-1945*, Uebel and Cohen (Eds.), Kluwer Academic Publishers, Dordrecht.

Pertot, V. (1970), *Ekonomika međunarodne razmjene Jugoslavije, Knjiga II: Dokumentacija,* Ekonomska biblioteka, VI kolo, Informator, Zagreb.

Stojanović, K. (1911), *Govori i rasprave političko-ekonomske*, II, Belgrade.

Todorović, M. (1911), *Carinski rat između Srbije i Austro-Ugarske od 1906-1910. godine: Studija iz naše međunarodne trgovine*, Štamparija "Dositej Obradović", Belgrade.

Trgovinski glasnik (1907), br. 82, Belgrade.

Vujić, M. (1903), *Najnoviji obrt u trgovinskoj politici* (Pristupna akademska beseda), Glas SKA, II raz., 41, LXVI, 1903, pp. 170-171.

Chapter 15

The Consequences of World War One on the Foreign Trade of the Kingdom of SCS and Bulgaria 1919-1929 – The Case of the Textile Industry*

Jelena Rafailović**
E-mail: jrafailovic@hotmail.com

Abstract: This paper presents a comparative study of the impact of WWI on the foreign trade of the Kingdom of SCS and Bulgaria in the period from the end of the war to the Great Depression (1919-1929), through an analysis of the export and import of textiles. The aim of paper is to compare the consequences of WWI on the industrialization of the two countries. I first present the general economic development trends of the Kingdom of Serbs, Croats, and Slovenes (SCS) and Bulgaria, then foreign trade in general, and finally a detailed analysis of the export and import of textiles, to see if there is a correlation between industrialization and market changes resulting from the war.

Key Words: First World War, Kingdom Of Scs, Bulgaria, Foreign Trade, Textile Industry

JEL Classification: N01, N14, N74, N94

INTRODUCTION

The First World War had a direct and significant impact on inter-war trade, primarily on supply and demand and also on the opening or entrance of new overseas markets. In the first post-war years in devastated Europe demand was primarily for food and then textiles. The Balkans was not an exception. Our paper presents the impact of WWI on the foreign trade of the Kingdom of SCS and Bulgaria in the period from the end of the war to the Great Depression (1919-1929) through an analysis of the export and import of textiles. Apart from a classic historical

* The paper is part of the project Tradition and Transformation – Historical Heritage and the National Identity of Serbia in the 20th century, (№ 47019) which is financed by the Ministry of Education, Science and Technological Development of the Republic of Serbia

** Faculty of Philosophy, Department of History, PhD candidate; Institute for Recent History of Serbia, research assistant

framework, the methodological framework includes comparability, a quantitative approach, and a case study. The issues covered refer to the quantitative analysis of export and import of the raw materials and products of the textile industry[1] – or export and import scope, value, and character of raw materials and semi-manufactured and manufactured products. A comparative analysis with Bulgaria, which according to all parameters had a similar textile industry, will provide a better overview of South Eastern Europe.

The main reason for the textile industry being the subject of this case study is that up to the Great Depression textiles were the biggest import to the Kingdom of SCS and Bulgaria. The main feature of the foreign trade in textiles in both countries was an increase in the importation of raw materials and a decrease in the importation of semi-products (yarn) and products (ready-made goods). Thus the textile industry was able to produce instead of importing ready-made goods. Based on this, some authors consider that the textile industry was the most developed example of industrialization. Therefore, there are several questions regarding the textile industry. To what extent did World War One affect the development of the textile industry? Was the textile industry sufficiently developed - as the majority of authors believe, based on the relation between semi-manufactured and manufactured products - that it could replace imported with domestic products? Or did World War One contribute to a more favourable textile industry without it boosting its development?

METHODOLOGY AND DATA

The aim of our paper is to comparatively present foreign trade in textile products in the Kingdom of SCS and Bulgaria in the period from the end of World War One to the Great Depression, in order to examine its importance in the industrialization of the two countries. I will first present trends in the Kingdom of SCS and Bulgaria's economic development, then foreign trade in general, and finally a detailed analysis of the export and import of textile goods, to see if there was a correlation between industrialization and market changes resulting from the war.

Statistical data on foreign trade trends in the Kingdom of SCS and Bulgaria during the inter-war period have mostly been preserved and are continuous, which is very rare for inter-war statistics, and thus it is possible to elaborate this issue

[1] The foreign trade of the Kingdom of SCS has not been extensively studied in Serbian or Yugoslav historiography, especially not comparatively with Bulgaria. The main foreign trade trends have only been considered generally in individual articles (Stefanović (1996); Pitić, (1989); Đurović (1986); Čalić (2004); Lampe & Jackson (1982); Kresal (1976); Drabek (1985)). To date, the most detailed monograph on foreign trade of the Kingdom of Yugoslavia is by the economist Vladimira Pertota, Ekonomika međunarodne razmjene. Jugoslavije, knjiga 1, analiza razdoblja između 1919 i 1968 godine, (1971). Zagreb; Pertot, Ekonomika međunarodne razmjene Jugoslavije, knjiga II, dokumentacija, (1970).)

from a quantitative point of view. Data on the exports and imports of the Kingdom of SCS are from *Foreign Trade Statistics for the Period 1918-1930*, and on Bulgarian foreign trade are from *the Statistical Yearbook of the Bulgarian Empire*[2] 1913–1930. However, data for the Kingdom of SCS for the years 1919 and 1920 are very unreliable, for various reasons resulting from the decentralisation of foreign trade policy: disorganized custom offices, the majority of custom officers still serving in the military, lack of customs formalities, application of different customs tariffs, custom offices neither asking for nor keeping statistical data. The Statistical Department was established at the beginning of 1920 and started to collect data in the second half of that year.[3] There was significant smuggling, silently supported by the state. In 1919-1920 the Central Customs Administration, through the Belgrade Financial Administration, exported 15 million dinars worth of goods without paying tax or keeping any records. Bajkić (1929) believes that in 1919-1920, 80% of border trade was smuggling, and all trade statistics before the end of 1923[4] are unreliable.

I have also used data from the Archives of Yugoslavia (funds of the Ministry of Trade and Industry and the Central Industrial Corporation) and current periodical publications.

GENERAL ECONOMIC DATA ON THE KINGDOM OF SCS AND BULGARIA

The consequences of the First World War were, primarily, social and political instability, both on domestic or state and international levels, which culminated in the Great Depression and then the Second World War. The Balkan countries did not avoid economic and political instability. The most visible consequences of the war were human and material losses. It is estimated that the European population deficit was between 22 and 24 million people (7% of Europe's pre-war population). Germany and Austria-Hungary suffered the biggest losses with over 5 million dead in each country, but in relative terms Serbia lost most people: one-third of pre-war inhabitants.[5] The total direct and indirect costs of WWI in 1919-1920 amounted to 337 million dollars (in pre-war US dollars).[6] The war produced huge economic

2 Статистически Годишник на Българското Царство 1913-1930, Here in after: *СГБЦ*

3 Statistika spoljne trgovine (1920), pp. 3-4; Алексић (2010), p. 55.

4 Milenković (1972), p. 284; Bajkić (1929), p. 564.

5 Aldcroft (2001), p. 7

6 Total direct costs were 186million dollars, and total indirect costs (which include: capitalized value of human life, property losses, loss of production, war relief, loss to neutrals) was 151million dollars. A number of authors have attempted to quantify the costs of the war and for most of them the starting point was Bogart's calculation from 1919-1920. His data can be reconsidered and reviewed, but in this paper data are presented in order to understand the context, without discussing them. Bogart (1920), p. 299; for critics of Bogart's calculations see: Broadberry & Harrison (2005), pp. 22-27.

upheaval, and all countries that participated experienced changes in the structure of production and consumption. As always with wars, World War One caused economic capacity to rise during the war and greater demand after the war, primarily for food and consumer goods. This increased capacity became redundant after the end of the war and the transfer from a war to a peacetime economy contributed to great shifts in world trade. The US and Japan increased their economic capacity considerably during the war and entered the world market when it ended, competing with European countries. As countries protected their economies with customs and cartels, market flexibility decreased.[7] In first post-war years there was high demand for textile and consumer goods. The textile industry was a light industry with customers in all social strata and covered the production and processing of wool, cotton, silk, flax, hemp, jute, and the production of rugs, hats, carpets, etc. In first post-war years the production of and trade in textiles faced destroyed production capacities and interrupted traffic connections. The most important short-term consequence of WWI for the textile industry was the greater demand for textile products, including in less developed countries,[8] which led to an increase in production. The long-term consequences of WWI for the textile industry were the emergence of new producers, strain and deterioration in world trade, currency instability, strong fluctuations in prices of raw textile materials, and new fashion trends.[9]

The main reason for comparing the Kingdom of SCS and Bulgaria is their similar macroeconomic indicators. Table 1 shows key indicators in order to better understand the general economic trends of both countries. The Kingdom of SCS and Bulgaria were predominantly agrarian countries, evidence of which is the numbers of agrarian population. In 1931 the Kingdom of SCS had a population of 13,883,000 of which 10,771,000 or 76% was agrarian. Bulgaria in 1926 (year of census) had a population of 5,696,000 of which 4,268,000 or 74% were connected to the land.[10] The net national income of the 'factory industry' in 1926 was 11.6% of the total in the Kingdom of SCS and 8.2% of the total in Bulgaria.[11]

[7] Feinstein &Temin &Toniolo(2008), pp. 25–27
[8] Sandberg (2005), p. 979; Pertot, (1971), p. 89.
[9] Jenkins (2005), p. 995.
[10] Lampe & Jackson, 1982, pp. 332–335.
[11] Ђуричић, Тошић, Вегнер, & П. Рудченко, (1927), p. 265.

Table 1: Structure of production in 1929[12]

	Bulgaria		Kingdom of SCS	
	Gross	Net	Gross	Net
Crops	63.6%	47.6%		37.2%
Livestock		26.9%		26%
Forestry		4.4%		7.9%
Extractive industry	1.7%	0.9%		1.8%
Manufacturing	**34.7%**	**8.2%**		**11.6%**
Building		0.8%		1.1%
Artisan		10.6%		10.6%

Sources: Lampe & Jackson, 1982, pp. 338-339; Ђуричић, Тошић, Вегнер, & П. Рудченко, 1927, p. 265; Data for Kingdom of SCS vary depending on the author[13].

The industrial sectors in the Kingdom of SCS and Bulgaria were small. According to most authors the textile industry is a key indicator of industrial development in both countries, and this study analyses the foreign trade in textiles. In the interwar period the textile industry in the Kingdom of SCS and Bulgaria was based on traditions of the Ottoman and Habsburg Empires dating back to the 19th century.[14] In Yugoslavia there were around 129 textile factories in 1919 and around 303 in 1929, and in Bulgaria there were 73 factories in 1921 and 198 towards the end of 1929.[15] Textile production in Bulgaria accounted for 13.4% of GDP in 1921 and 23.08% in 1929 (the food industry had the greatest share). The index of industrial growth in Bulgaria increased from 44% in 1921 to 297% in 1930. Average annual production growth was 23.5% in the period 1921–1930, and the share of the textile industry in total production increased from 13.40% in 1921 to 23.08% in 1930.[16] There are no precise data for the Kingdom of SCS, but an increase in the textile industry is evidenced by a 57%increase in labour, a 57% increase in power, and a 33.71% increase in capital in the period 1918–1928.[17]

There were several reasons that for the expansion of the textile industry. Business people lacked capital, and the construction of textile factories did not require much capital. There were many unskilled workers, whom the textile industry was

---

[12] Percentages of gross crop production for Bulgaria are related to crops and livestock; forestry is excluded. Net values are not value-added. Net crops are gross crops minus requirements for seeds; inputs from other sectors are not subtracted. Net livestock is gross livestock minus cereal crops used for feed. Net manufacturing is gross manufacturing minus raw materials and fuelcosts. (Lampe & Jackson, 1982, pp. 400)

[13] According to Stajić, industry and mining had a 17.8% share in real national income. See: Stajić (1959), p. 19.

[14] Balkan and foreign historians disagree regarding the development of the textile industry after the independence of Serbia and Bulgaria. For more details see: Palairet (2009); Беров (2012).

[15] StatistikaindustrijeKraljevineJugoslavije, saadresaromindustriskihpreduzeća (1941), pp. 60-61; СГБЦ (1931), p. 242.

[16] Lampe & Jackson(1982), pp. 404.

[17] Kukoleča (1941), pp. 113, 221

able to absorb and employ. There was a state policy of protective customs duties, a market demand for articles for everyday use due to war destruction, an increase in population, and more fashionable consumption habits.[18] The reasons for the expansion of the textile industry – lack of capital, unskilled workers, protective customs policy, poverty – were structural problems rather than a sound basis for the development of industry.

GENERAL FEATURES OF FOREIGN TRADE

Foreign trade relations in both countries must be considered in the framework of general economic flows and international economic relations. In the first ten years the international economy was overcoming the consequences of WWI, so in 1921–1925 it was first necessary to stabilize the monetary system and then to reach an economic balance in 1925–1929. The Great Depression period was characterized by a relatively liberal foreign economy, followed by small state interventions with the aim of stabilizing state economies. At the beginning the state interventions were various trade prohibitions and exchange limitations, followed by customs protectionism.[19] The organisation of trade with foreign countries in the Kingdom of SCS in the period 1918-1921 is a good example of the post-war chaos and attempts to centralize foreign trade.

In the first post-war years the Kingdom of SCS directed the economy towards state recovery primarily by a customs policy favouring imports and limiting various exports, restitutions, reparations, and loans. The aims of the customs policy were to provide food for the population and to obtain basic means of production. In order to alleviate the consequences of the war, the Ministerial Council of the Kingdom of SCS adopted a decision on 30 July 1918 banning exports and tax-free imports, but the Ministry of Trade and Industry soon started issuing individual export licences, so-called "izvoznica". For the purpose of state centralization, a regulation was adopted in March 1919 expanding the customs laws, trade agreements, and tariffs of the Kingdom of Serbia to cover the entire territory of the Kingdom of SCS. Apart from a decentralized customs system, another foreign trade problem for the Kingdom of SCS was monetary. Most exports and imports were directed towards Austria and Hungary (food, raw materials, and consumer goods), which had unstable and depreciated currencies. In order not to pay for goods with money a system of barter was established. In November 1919 export licences and compensation were replaced by a system of contingents, in which certain prohibited export goods

[18] Čalić(2004), p. 405; AJ, 76-55-95, A record from the Textile Industry Conference, April 15, 1927; A letter of the Central Industrial Corporation of the Kingdom of Serbs, Croats and Slovenes to all regional members regarding the Textile Industry Conference, April 23, 1928.

[19] Jenkins(2005), p. 995; Pitić(1989), p. 109.

could be exported and others could be exported in limited quantities. By the end of the year export customs and regulations regulating foreign currency inflow had been established. Foreign trade was completely regulated by the adoption of a general customs tariff in 1925, with the primary aim of protecting the agrarian sector.[20] The 1925 customs tariff was considered to be the basis of the development of the textile industry[21], but in fact the textile industry was not protected to the same degree as other industries.[22] In 1927 the Bulgarian tariff on textile imports was 87.5%, while the Yugoslavian tariff was only 12.2%.[23]

Yugoslavia's largest import was cotton, followed by grapes, wool, machinery, and electrical devices.[24] The import-export ratio of agricultural and industrial products was similar in both the Kingdom of SCS and Bulgaria. In the Kingdom of SCS, on average, industry constituted 30% of exports and 94% of imports. Before the Depression textile products dominated imports, but were later replaced by ferrous metallurgy. Thus textile product imports were crucial in maintaining a foreign currency balance.[25] Food and tobacco were 90.8% of Bulgaria's exports in 1922-1924 and about 80% at the end of the twenties, while industrial imports were 77.4% and 77.9%, respectively.[26] Both countries exported most to Germany and Austria, followed by Italy, Turkey, and Czechoslovakia, and imports were mostly textile goods, followed by metals, cotton, machinery, equipment, and appliances.[27]

Foreign trade in both countries was characterized by three key features: 1)low exchange level per capita (see Table no. 3)[28]; 2)the predominant role of primary products in exports and of industrial products in imports; 3)export potential based on a small number of export articles (sixteen articles constituted 68.2% of exports, and the first four 45.1% of the total).[29]

The general tendencies of foreign trade in the Kingdom of SCS and Bulgaria are presented in Graphs 1–4. There were considerable differences in trends. In the Kingdom of SCS in 1919–1923 exports went up, more in value than in quantity, due to the economic recovery after the war, with more jobs, greater production,

[20] Stefanović(1996), p. 96; Lakatoš(1929), VI, p. 2; Pitić(1989), pp. 112–113; Алексић (2010), p. 57; Lazarević(1926), AJ 76-52-47, pp. 1-2; Đurović(1986), p. 274. Bulgaria didnot have similar problems to the Kingdom of Serbsin the organization of foreign trade, so I will not go into details.

[21] Gregorić (1937), AJ 76-92-181.

[22] Čalić(2004), p. 276.

[23] Lampe & Jackson (1982), p. 412.

[24] Mirković(1962), p. 303; Uporednipregledglavnihpredmetauvozaiizvoza, Statistika spoljne trgovine, 1920–1930; Lampe (1981), pp. 458–460.

[25] Pertot (1971), p. 88; Pertot, (1970), p. 17.

[26] Drabek (1985), pp. 407, 470-471.

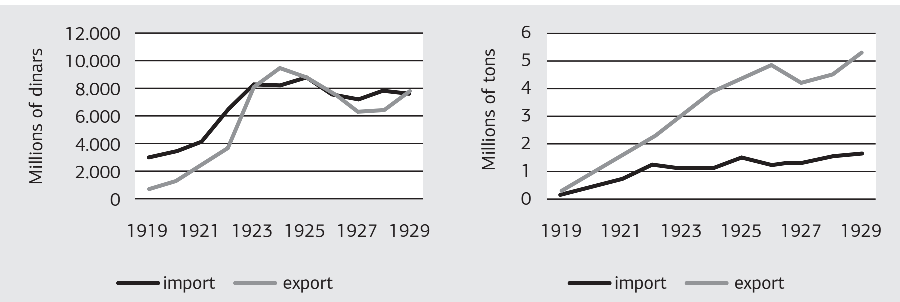
[27] Mirković(1962), p. 303; Uporednipregledglavnihpredmetauvozaiizvoza, Statistika spoljne trgovine, 1920-1930; Lampe (1981), pp. 458-460.

[28] Author's calculation based on Statistical Yearbook, League of Nations, 1933–1934, p. 195; Pertot provides slightly different data for the Kingdom of SCS – 6.7 dollars of current value in the period 1919-1925; or 8.8 in the period 1926-1929 in the Kingdom (Pertot (1970), p. 15).

[29] Drabek (1985), pp. 380, 407-408, 475; Pertot (1971), p. 31-32; Kukoleča (1941), p. 284.

cheaper imported raw materials, and semi-manufactured products..[30] In the following period the foreign trade structure changed, with more exports but a fall in export value due to changes in export prices. Due to the stabilisation of currency, price fluctuations ceased and prices of goods fell. The Kingdom of SCS's foreign trade peaked in 1924 and 1925 and recorded positive balances in 1926 and 1929. Bulgaria, on the other hand, peaked in 1922 and then declined, and recorded positive balances in 1924, 1926, and 1927. A positive balance in 1922 was the consequence of the Greece-Turkey war (1919–1922).[31] Pertot defines two periods in the Kingdom of SCS's foreign trade, the first from 1919 to 1925 and the second from 1926 to 1929, believing that the favourable foreign trade balances in 1924 (in dinars) and in 1925 (in dollars) were due to the cyclical results of inflation and foreign depreciation of dinar, and because imports were kept at a low level. The stabilisation of the Yugoslav currency was a favourable influence, alleviating strong price fluctuations, as well as the adoption of the customs tariff in 1925, which protected domestic products. In the following period, from 1926 to 1929, there was a fall in foreign trade as a consequence of the beginning of the global agrarian crisis and fall in value of agrarian products and dinar exports, which started to decrease compared to industrial products and imported (dollar) products. A positive balance in 1929 can be explained by an exceptionally fertile year for maize.[32]

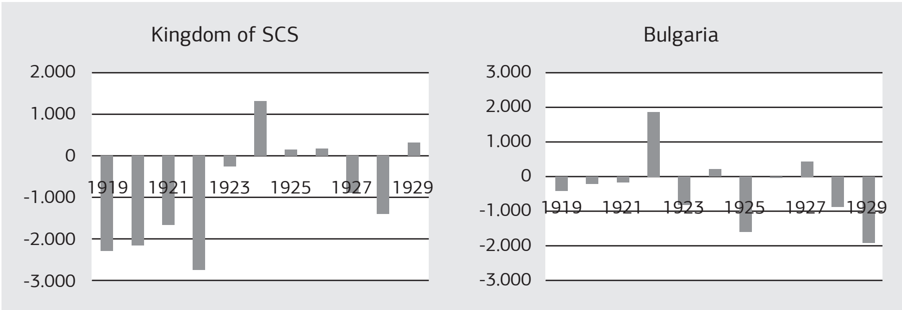
Graphs 1 and 2 – Value and Volume of Foreign Trade of the Kingdom of SCS, 1919–1929



Sources: *Statistika spoljne trgovine 1919-1926, p. VII, 1923-1930*, p. XV; *Statistički godišnjak*, II, 1930, (1933), p. 214.

[30] Kukoleča (1941), pp. 280, 284.
[31] Неделчев (1937), p. 11.
[32] Kukoleča (1941), p. 284. Pertot (1971), pp. 28-29, 52.

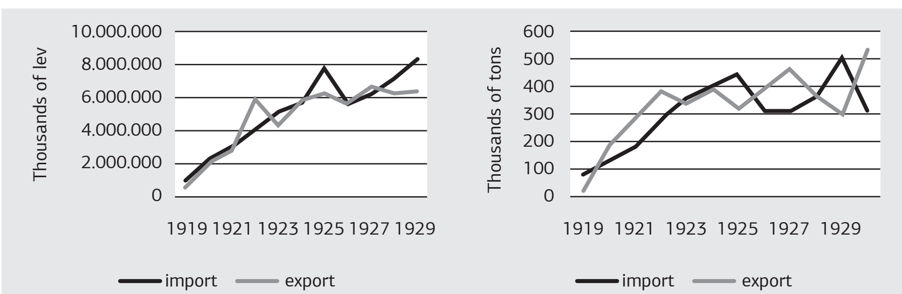
Graphs 3 and 4 – Balance of foreign trade in the Kingdom of SCS (millions of dinars) and in Bulgaria (thousands of levs),1919–1929



Sources: *Statistika spoljne trgovine 1919-1926, p. VII, 1923-1930*, p. XV; *Statistički godišnjak*, II, 1930, (1933), p. 214; Статистически Годишник на Българското Царство, *1929- 1930*, pp. 199.

The First World War downgraded Bulgarian foreign trade and total imports in 1919 were 7 times lower than in 1911, while total exports were 52 times lower. In the following years a slow and continuous growth in exports was recorded but in 1924 they had reached only 68.6% of the 1911 amount, while imports grew even more slowly and reached 37.7% of the 1911 amount. The poor progress in foreign trade was due to the slow recovery of the agricultural and industrial sectors and the loss of pre-war markets. The key Bulgarian trade partners after the war were Italy, Germany, and France, while the two most important and biggest importers of its goods – Austria and Turkey – held seventh and eighth positions in terms of imports. This change in market structure resulted in a negative trade balance. In a similar way as in the Kingdom of SCS, in Bulgaria the state issued currency controls and limited the amount of currency for imports in order to maintain monetary stability. The Direction for economic and social care was responsible for managing foreign trade by allowing or disallowing import and export of various goods.[33]

Graphs 5 and 6 – Value and volume of Bulgaria's foreign trade, 1919-1929



Source: Статистически Годишник на Българското Царство, 1929–1930, p. 199.

[33] БеровЛ. (1989), p.415; Неделчев (1937), pp.12-13, 85, 87.

The foreign trade of the Kingdom of SCS and Bulgaria was insignificant in Europe. Ingvar Svenilson (1954) pointed to the following data: in 1928 the exports of the Kingdom and of Bulgaria amounted to 1.08% and 0.3% of total European world exports and 1.15% and 0.43% of exports within Europe, respectively. Both countries exported mostly to European countries – 89.4% of goods from the Kingdom of SCS and 95.6% of goods from Bulgaria were exported to Europe. Imports were even worse. Imports to the Kingdom of SCS and to Bulgaria were 0.73% and 0.27% of total European imports from the entire world, and 1.02% and 0.47% of the total from Europe, respectively.[34] When comparing the per capita exports and imports of Bulgaria and the Kingdom of SCS with other European countries an identical picture is obtained: both Balkan countries were at the bottom of the European ladder with very low trade values per capita (Table 3.)

Table 3. Imports and exports per capita in 1928 in selected European countries in U.S.A. gold dollars

Country	Imports per capita	Exports per capita	Country	Imports per capita	Exports per capita
Denmark	125.43	117.64	Czechoslovakia	39.04	43.14
Belgium	111.17	107.37	Italy	28.51	19.16
Netherlands	139.56	103.29	Hungary	24.56	16.74
Switzerland	126.94	101.12	Greece	25.83	12.64
Great Britain	114.13	76.80	Poland	12.40	9.25
France	51.21	49.74	Romania	10.95	9.17
Austria	68.08	46.41	Kingdom of SCS	10.37	8.53
Germany	52.27	45.83	Bulgaria	8.97	7.87

Source: *Statistical Yearbook of the League of Nations*, 1933-1934, Geneva 1934, p. 195;

THE EXPORT AND IMPORT OF TEXTILE PRODUCTS

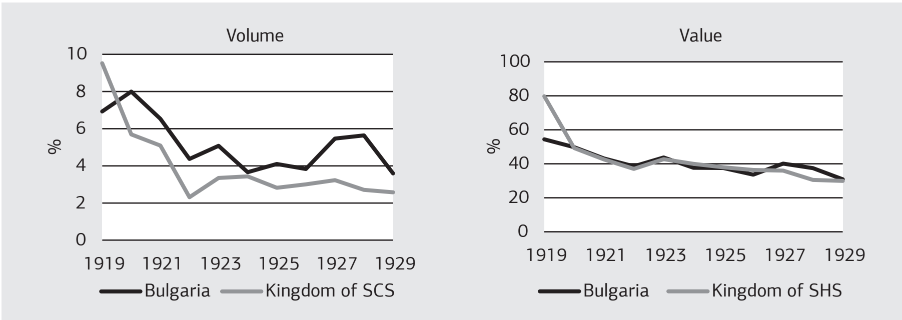
The interwar period was characterized by a constant fall in the export of ready-made products and a rise to a certain degree in the import of raw textile materials and semi-manufactured products.

As already noted, textiles were the largest import. During the whole period in both countries the total export of textile goods (in tons) was less than 10% of total imports, but the total value of imported goods was 40%-42% (see Graphs no 8, 9). In 1919-1929 Bulgaria and the Kingdom of SCS imported an average of 154,942 tons and 390,217 tons of textile goods, respectively; an average of 14,086 tons and 35.474 tons per year. Average imports per capita in Bulgaria in 1919–1929 were

[34] Svennilson(1954), pp. 171, 173

around 2.46 kg and in Yugoslavia around 2.72 kg. In 1920–1929 (excluding 1919 as an unstable year)in Bulgaria imported textile goods grew by 6% per annum and in Yugoslavia by 6.2 %.

Graphs 8 and 9. Quantity (t) and value (dinars, levs) of imported textile goods, Bulgaria and Kingdom of SCS, 1919-1929



Sources: Статистически Годишник на Българското Царство, (1922-1932); *Statistika spoljne trgovine*, (1920-1930).

Imports to Bulgaria and the Kingdom of SCS showed almost identical trends. The only significant deviation was in 1919 when textile imports to the Kingdom of SCS were 79.73%, but this can be considered an irregularity due to incorrect data for 1919,the great poverty after the war, general demobilisation, and the need for clothes.[35] In the following ten years textile imports in both Bulgaria and the Kingdom of SCS tended of fall; in Bulgaria from 54.4% in 1919 to 30.9% in 1929, and in the Kingdom of Yugoslavia (excluding the irregular year of 1919) from 49.25% in 1920 to 29.96% in 1929. The negative annual growth rate in Bulgaria and Yugoslavia was -5.01% and -4.85% respectively.

Due to the small share of industrial products in exports and the poor conditions for processing raw materials, textile exports were minimal. From 1919 to 1929 Bulgaria's average textile exports comprised 3.64% of total exports, and in Yugoslavia they were even lower, at 2.12%. In volume, textile goods in the Kingdom accounted for 0.84% and in Bulgaria 0.26% of overall exports.[36]

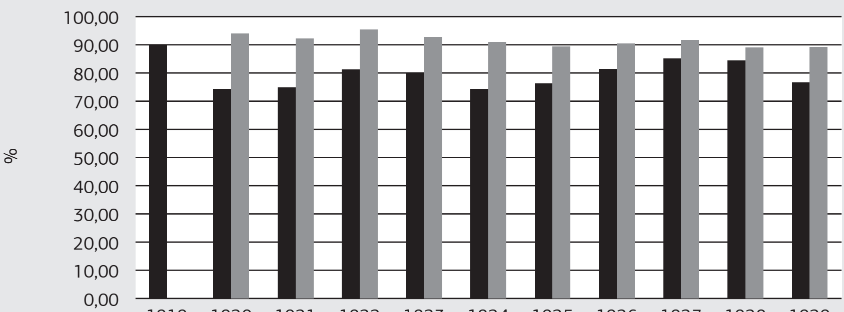
There are several explanations in the literature for the change in import structure (reduced import value of textile materials and increased export quantity). Vladimir Pertot (1971) believes that the key reasons in the Kingdom of SCS were a fall in foreign prices of textile products and substitution effect. After the war there was a sudden increase in the number of factories, which increased imports of yarn and raw materials, and a decrease in the importation of specific and valuable cloth. Apart from the quantity-value change in import structure there was a shift in the

[35] Предлог министарству војске и морнарице (1919), AJ 65-1-2.
[36] Author calculation, СГБЦ (1922-1932); Statistika spoljne trgovine (1920-1930).

structure of textile imports from final products to semi-manufactured products and raw materials, and from more expensive wool to cheaper cotton, in order to maintain the foreign currency balance.[37]

Analysis of the import of specific textile products will show the structure of the foreign trade in textile imports. Textile goods can be divided into raw materials (cotton, wool, silk, hemp, jute), semi-manufactured products (cotton, wool, or silk yarn), and final products (cloth and ready-to-wear clothes). Our analysis covers only wool and cotton, as they constituted the majority of textile imports (see Graph 10). In Bulgaria, cotton and wool constituted 79.83% on average, while in the Kingdom of SCS they constituted as much as 91.83% of total textile imports during the entire period. Cotton imports were more important than wool, and amounted to 90% in Bulgaria in 1922. However, cotton became less important, and in 1929 it amounted to 78.13%. The Kingdom of SCS also imported 76% more cotton than wool in 1921 and 71% more in 1929. The import of silk in the first post-war years was very low due to limited demand and lack of processing factories.[38]

Graph 10. Overall share of cotton and woollen goods in textile imports



	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929
■ Bulgaria	89,72	74,01	75,12	81,64	79,72	74,59	76,12	81,28	85,07	84,07	76,84
■ Kingdom of SCS		93,76	91,80	95,01	92,67	90,95	89,21	90,57	91,63	88,89	88,93

Sources: *Statistika spoljne trgovine*, (1920-1930); *Списание на Българското икономическо дружество*, 1934, pp. 444-445; *Вноса на текстилни материали и изделиявъ България* (1929), pp. 348, 356-363.

COTTON

The import of cotton, primarily as cotton yarn and ready-to-wear clothes, dominated in Bulgaria and Yugoslavia. The main reason for the considerable demand for cotton in this period was price: these consumer articles were of lower quality and available to consumers from the widest strata. Furthermore, the development of

[37] Pertot (1971), pp. 89.

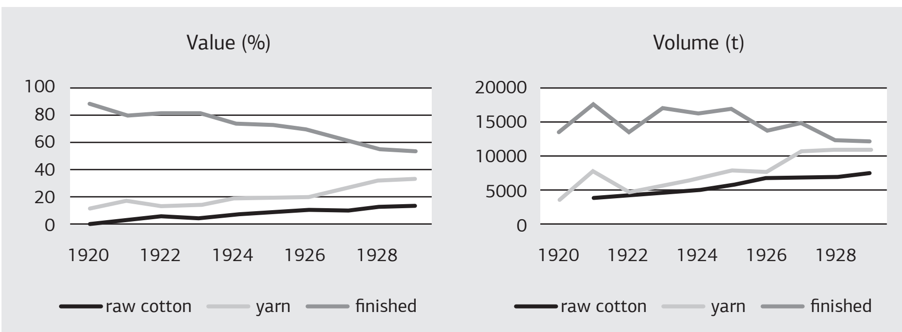
[38] Kukoleča(1941), p. 300.

cotton textile factories did not require much investment.[39] Due to climate and geography cotton was produced in both Bulgaria and the Kingdom of SCS, but not in sufficient quantities and not of sufficient quality. The average annual cotton yield in the Kingdom of SCS was around 222 tons in 1920-1928, and in Bulgaria 434 tons. However, because the fibre was too thin and short it was only used in small quantities, mixed with foreign cotton.[40]

The total import of cotton goods per capita was very similar in volume in both countries. In the Kingdom of SCS the average annual import of cotton goods in 1921-1929 was 2.24kg per capita, of which finished goods had the biggest share of 1.17kg per capita. The import of finished goods declined from 1.48kg per capita in 1921 to 0.89kg per capita in 1929.Bulgaria imported 1.92kg per capita of cotton goods annually, mostly yarn (1,35kg per capita). The import of finished goods also declined in 1922-1929 (from 0.75kg per capita to 0.38kg per capita) and imports of raw materials grew (from 0.029kg per capita to 0.36kg per capita).[41]

In the period 1920-1928 5.738 tons of raw cotton were imported to the Kingdom of SCS and in 767 tons to Bulgaria. The Kingdom imported 3.764 tons in 1921 and 7.598 tons in 1929, an annual increase of 9.18%. The import of cotton yarn also grew by 13.3%, followed by a fall (See Graphs 11 and 12). The only negative annual growth, -1.13%, was in the import of ready-to-wear clothes and cotton textiles (See Table 4). The value of imported cotton goods indicates apparently similar tendencies. The annual increase in the import of raw cotton was 23.84%, while the increase in yarn imports was slightly lower, 13.97%. Again, a negative growth,-4.21%, was recorded in the import of cotton ready-to-wear clothes (See Table no.5).

Graphs 11 and 12. Value (%) and volume (t) of raw cotton, cotton yarn, and finished products imported to Kingdom of SCS.



Source: *Statistika spoljne trgovine*, (1920-1930)

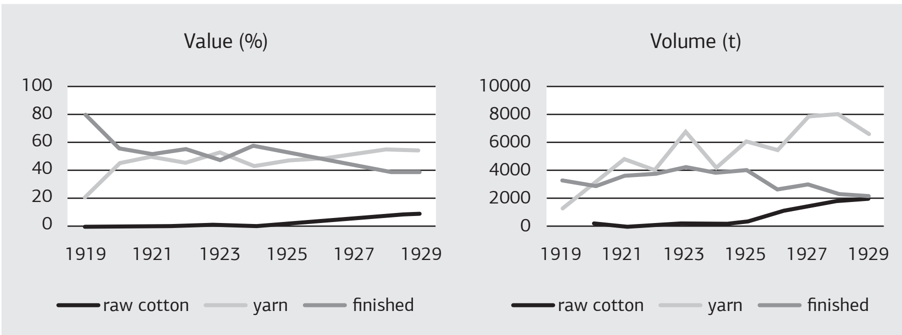
[39] Kukoleča (1941), p. 300-301

[40] Mihajlović (1932), pp. 4-5; Statistical Yearbooks of the League of Nations, (1927-1930)

[41] Calculation based on: *Statistika spoljne trgovine*, (1920-1930), *Списание на Българското икономическо дружество*, 1934, pp. 444-445; *Вноса на текстилни материали и изделиявъ България* (1929), pp. 348, 356-363; *Statističkigodišnjak*, II, 1930, (1933), p. 61; *СГБЦ*, 1932, p. 16.

In Bulgaria the tendencies were similar, except in cotton yarn imports (Graphs 13, 14). Raw cotton imports increased by 28.36% and yarn imports by 18.23%, while the import of semi-manufactured products decreased by -4%. The annual import of raw cotton grew by 44.91%, yarn by 23.71%, and semi-manufactured products by 4% (see Tables 4 and 5). In 1925 there was a huge fall in the importation of ready-made products and a rise in the importation of cotton yarn and raw materials due to the establishment of the cotton yarn processing factory, Car Boris, which contributed to the opening of other new factories for the production of cotton materials.[42]

Graphs 13 and 14. Value (%) and volume (t) of Bulgarian imports of raw cotton, cotton yarn, and finished products



Sources: *Списание на Българското икономическо дружество*, 1934, pp. 444-445; *Вноса на текстилни материали и изделиявъ България* (1929), pp. 348, 356-363.

Table 4. Annual growth rate of volume of cotton imports (%) (100-1920)

	Kingdom of SCS			Bulgaria		
	raw cotton	yarn	finished	raw cotton	yarn	finished
1920-1923	10.15	50.59	13.58	-33.18	83.46	3.99
1924-1926	11.61	15.79	3.4	12.32	27.17	3.65
1927-1929	9.22	15.14	-0.24	30.28	22.36	-8.5
1920-1929	9.18	13.33	-1.13	28.36%	18.23	-4

Table 5. Annual growth rate of value of cotton import (%) (100-1920)

	Kingdom of SHS			Bulgaria		
	raw cotton	yarn	finished	raw cotton	yarn	finished
1920-1923	122.08	29.96	5.34	-28.55	131.43	17.78
1924-1926	52.08	22	5.73	25.82	39.6	14.2
1927-1929	27.52	15.68	-8.45	48.95	27.88	6.95
1920-1929	23.84	13.97	-4.21	44.91	23.71	4.71

[42] Вноса на текстилни материали и изделия във България (1929), pp. 349, 358.

The most significant change in the foreign trade of both countries was the increased importation of raw cotton and decreased importation of semi-manufactured and manufactured products. There were several reasons for this. Pertot points to two: effects of substitution function and a fall in cotton prices on the foreign market. However, the very structure of the textile industry played a significant role in the development of both countries. The substitution effect was reflected in planned import compensation: an absolute fall in cotton imports was compensated for by a rise in the quantity of cheaper raw cotton, and not of more expensive final product. Still, the increase in textiles did not satisfy current demand. The second reason is a constant fall in cotton prices due to cheaper American cotton.[43] Our calculation of the difference between the price of raw American cotton, which constituted the majority of global consumption, and of raw cotton from the Kingdom of SCS and Bulgaria is different from Pertot's. Pearson calculation of correlation between these indicators does not show strong correlation, it does not imply causation (for Bulgaria -0.329 for volume, -0.33 for value. For Kingdom of SHS -0.54 for volume and -0.28 for value)[44].

The structure of the textile industry in both countries also had a significant influence on cotton imports. Bulgaria began importing yarn and raw materials in 1925, because of the establishment of the textile factory, Car Boris, which was the first large factory able to process raw cotton and cotton yarn. The situation in the Kingdom of SCS was similar. In the Kingdom of SCS during the Great Depression there were around 10 cotton mills, which were unable to satisfy domestic needs. On the other hand, the reason the number of cotton mills operating to full capacity in the first post-war years was insufficient was primarily because the factories had not recovered from war destruction.[45]

WOOL

Many fewer woollen products were imported than cotton. In the period 1919–1929 the Kingdom of SCS imported a total of 60,194 tons of woollen products (an annual average of 6,200 tons), and 276,225 tons of cotton products (an annual average of 27.622). The rural population made their own wool cloth, rather than buying imports.[46] It was the same in Bulgaria, which imported 21,017 tons (6,306 tons on

[43] Pertot (1971), pp. 88–93.

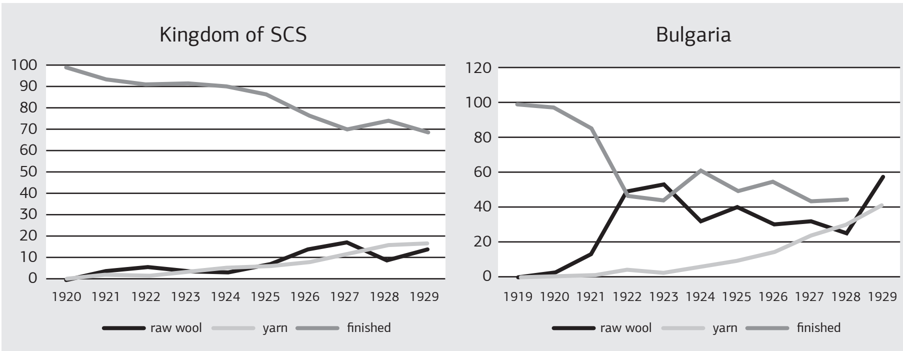
[44] Перспективите на цените на памук (1929), p. 456; Списаниена Българското икономическо дружество (1934), pp. 444–445; Вноса на текстилни материали и изделиявъ България (1929), pp. 348, 356–363; Statistika spoljne trgovine (1920–1930)

[45] Mihajlović (1932), p. 4–5

[46] Only two wool factories had the capacity to produce fine woollen goods, Teokarević's factories in Paraćin and Vučje. The remaining mills mainly processed and produced soft cloth called "šajak", either for the peasants or the military.

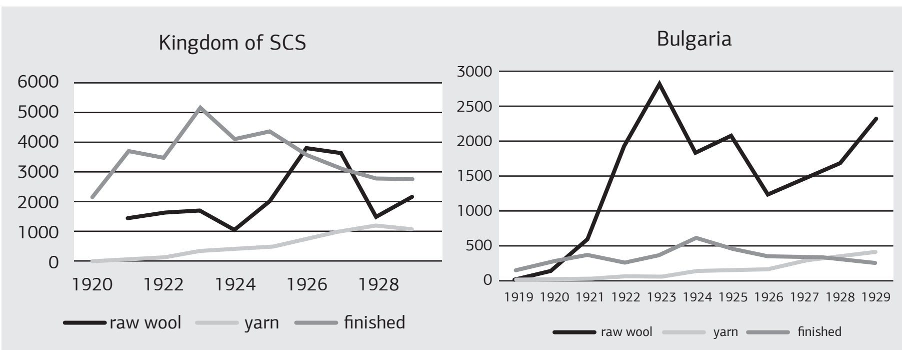
average)of wool and 102,707 tons (9,333 tons on average) of cotton. There is a clear difference in value, as the imported wool and woollen products were worth 3.8 billion Levs, and the cotton 14.6 billion Levs. In the Kingdom of SCS the difference was smaller – woollen products were worth 6.5 million dinars and cotton products 17.2 million dinars.

Graph 15. Raw, yarn, and finished wool imports as percentage share of total, Kingdom of SCS and Bulgaria



Sources: *Списание на Българското икономическо дружество*, 1934, pp. 444–445; *Вноса на текстилни материали и изделиявъ България* (1929), pp. 348, 356–363; *Statistika spoljne trgovine*, (1920-1930)

Graph 16. Volume of imported woollen goods in Yugoslavia and Bulgaria (t)



Sources: *Списание на Българското икономическо дружество*, 1934, pp. 444–445; *Вноса на текстилни материали и изделиявъ България* (1929), pp. 348, 356–363; *Statistika spoljne trgovine*, (1920-1930)

Graphs 15 and 16 show the quantities of wool imported by the Kingdom of SCS and Bulgaria. In the Kingdom of SCS the percentage shares were similar to those of cotton, but the biggest annual growth was in wool yarn, not raw wool. Imports of woollen yarn increased annually by 36.65% and raw wool by 23.98%; but the import of finished woollen goods was low, with an increase of only 1.74% per year. The figures for Bulgaria are similar: yarn imports increased by 111% per year, raw materials by 61.2%. The import of finished woollen goods, which was almost 100% in the first years after the war, had decreased by 40% in 1929, with an annual decline of -27.9%. In the Kingdom yarn imports showed the biggest increase by volume of 32% per year, while the only negative import trend was in finished goods, at -3.5% per year. Bulgaria showed the same tendencies: yarn imports increased in volume by 94% per year, while the volume of imported woollen material had a negative growth rate of -0.06% per year.

There is the question of whether Bulgaria and Yugoslavia had enough sheep in order to provide sufficient wool for their needs.[47] In the period 1925–1928 the Kingdom of SCS had around 7,824,000 and Bulgaria around 8,739,000 sheep, lagging behind Spain, France, Great Britain, Italy, and Romania. The wool was of very low quality. In the Kingdom of SCS wool exports were taxed to boost the domestic industry, but domestic wool could only make rough woollen cloth and so imported wool was needed.[48] The situation was similar in Bulgaria: the rough woollen cloth produced had limited possibilities for industrial use, and was used mainly in villages (out of 12,500 tons of wool produced in Bulgaria 10,000 to 11,000 tons remained in the villages), while the urban population wanted high quality wool.[49]

The data on imports of wool per capita show lower imports of wool in relation to cotton and somewhat different industry structures: the woollen textile industry was more advanced in Bulgaria. In 1921-1929 the Kingdom of SCS annually imported an average of 0.5 kg per capita of woollen goods, and finished woollen products of 0.28kg per capita were the biggest import item. Bulgaria imported 1.06 kg per capita of woollen goods annually, but the largest share of woollen imports was raw wool, at 0.33kg per capita.[50]

Thus wool import trends indicate the same tendencies, but not in absolute values. The reason is that the rural population, which constituted 75% of the total population in both countries, produced its own wool. The price of wool was the same as cotton until 1924, but as of 1925 prices started to diverge. Changes in import structure were not only the result of the substitution effect[51], but also of a long-term tendency for global cotton prices to fall. Woollen fabrics were burdened with disproportionately high import taxes in both the Kingdom of SCS and Bul-

[47] One sheep provided on average around 3kg of wool per year.

[48] Uloga tekstilne industrije u našoj spoljnoj trgovini, 12, 1932, pp. 4-5.

[49] Стаинов (1937), pp, 63, 64; Неделчев (1937), p. 57.

[50] Calculation based on: *Списание на Българското икономическо дружество*, 1934, pp. 444–445; *Вноса на текстилни материали и изделиявъ България*(1929), pp. 348, 356–363; *Statistika spoljne trgovine*, (1920-1930); *Statističkigodišnjak*, II, 1930, (1933), p. 61; *СГБЦ*, 1932, p. 16.

[51] Pertot calculated the true value effect of substitution by separating it from the effect of world price trends, taking 1925 as the base year, which is when the Temporary Customs Tariff was declared. With stable prices, the substitution effect of imports was around 35% in the period 1925-1939. (For more details, see: Pertot (1971), pp. 90.)

garia, whereas raw wool and cotton were tax-free as long as it was not possible to obtain them domestically.[52]

CONCLUSION

This short statistical review of wool and cotton exports and imports clearly indicates a decline in imported final textile products and a rise in imported raw materials. Some authors believe that this is a clear indicator of the country becoming industrialized and a growth in the production capacities of the textile industry,[53] whereas others see a clear example of underdeveloped industry.[54] In addition, the importation of textile products to the Kingdom of SCS and Bulgaria in the interwar period was actually an issue of trying to maintain a positive foreign currency balance. A change in imports from the more expensive final products to cheaper raw materials contributed to decreased import value, and therefore to maintaining the balance. This structural change was not the result of successful domestic production but of other factors, which were the result of the First World War.

We return to our original question: did the changes in foreign trade structure that resulted from World War One have a positive influence on market conjuncture, thereby enabling the development of the textile industry (which means that there was no structural development of the textile industry)? The First World War had the same impact on both countries – a high demand for textile goods (high share of textile products in imports, particularly ready-to-wear clothes); a change in market trends (new import and export markets); state intervention in the economy (customs tariffs); large price fluctuations (the relation between cotton price–cotton imports); new fashion trends (different consumer habits of urban and rural populations). On the one hand, all of this had a positive impact on the development of the textile sector in post-war conditions, but on the other hand it did not change inherited structures dating back to the 19th century and the economic problems of the Balkan region.

---

52 Pertot (1971), pp. 90-91.

53 AJ, 76-52-85, Лазаревић, (**1932);** Rozenberg, Kostić, (1940), p. 188; Đurović (198),p. 31; Lakatoš (1933), p. 131; Tekstilnaindustrija I tekstilnoradništvo u Jugoslaviji (1936),p. 9; Mihajlović, D. (1932), p. 5; Kresal (1976), p. 83.

54 Promene u potrošnji i proizvodnji tekstilija, 4, 1934, pp. 73, 75; Pertot (1971), pp. 88-93; Čalić, p. 408.

REFERENCES

Sources

Archives of Yugoslavia, Ministry of Trade and Industry (65)

Archives of Yugoslavia, Central Industrial Corporation (76)

Statistics

Statistical Yearbooks of the League of Nations, (1927-1930), League of Nations Economic and financial section, Geneva.

Statistički godišnjak, knjiga II, 1930. (1933), Opšta državna statistika, Beograd.

Statistika industrije Kraljevine Jugoslavije, sa adresarom industriskih preduzeća, (1941), Ministarstvo trgovine i industrije, Beograd.

Statistika spoljne trgovine, Kraljevine Srba, Hrvata i Slovenaca za godine 1920-1930, Ministarstvo finansija Generalna direkcija carina, Beograd.

Статистически Годишник на Българското Царство 1913-1930, Главна дирекция на статистиката, София

Books/articles

Aldcroft, D. H. (1921), *The European Economy*, Routledge, London and New York.

Bajkić, V. (1929). "Naša spoljna trgovina", in: *Jubilarni zbornik života i rada Srba, Hrvata i Slovenica 1918-1928, II deo.*

Bogart, Ernest L. (1920), *Direct and Indirect Costs of the Great World War*, Oxford University Press, New York.

Broadberry, S., & Harrison, M. (2005). *The economics of world war one,* Cambridge University Press, Cambridge.

Drabek, Z. (1985). "Foreign Trade Performance and Policy", in: M. C. Kaser, & E. A. Radice, *The Economic History of Eastern Europe 1919-1975,* Clarendon Press, Oxford.

Feinstein C., Temin P., Toniolo G., (2008), *The World Economy between the Wars*, Oxford University Press, Oxford

Đurović, S. (1986), *Državna intervencija u industriji Jugoslavije 1918-1941,* Institut za savremenu istoriju, Beograd.

Jenkins, D. (2005). "Wool textiles in the twentieth century", in: D. Jenkins, *The Cambridge History of Western Textiles,* Cambridge University Press, Cambridge.

Kresal, France (1976), *Tekstilnaindustrija v Sloveniji, 1918-1941*, Borec, Ljubljana.

Kukoleča, S. (1941). *Industrija Jugoslavije 1918-1938,* Beograd.

Lakatoš, J. (1929). *Privredni almanah jugoslovenskog Lloyda,* Zagreb.

Lakatoš, J. (1933). *Jugoslovenksa privreda, jubilarno izdanje Jugoslovenskog Lloyda,* Zagreb.

Lampe, J. R., & Jackson, M. (1982), *Balkan Economic History, 1550-1950 From Imperial Borderlands to Developing Nations,* Indiana Univ. Press, Bloomington.

Mihajlović, D. (1932), "Uloga tekstilne industrije u našoj spoljnoj trgovini", in: *Glasnik zavoda za unapređivanje spoljne trgovine*, 12.

Milenković, M. (1972). "Ekonomske prilike u Srbiji i problemi besposlice u svetlu posledica prvog svetskog rata", in: *Drugi kongres KPJ,* Slavonski Brod, pp. 281-289.

Mirković, M. (1962), *Ekonomska historija Jugoslavije,* Zagreb.

Palairet, M. (2009), *Balkan Economies, 1800-1914, the Evolution without Development,* Beograd.

Pertot, V. (1970), *Ekonomika međunarodne razmjene Jugoslavije, knjiga II, dokumentacija,* Zagreb.

Pertot, V. (1971), *Ekonomika međunarodne razmjene Jugoslavije, knjiga 1, analiza razdoblja između 1919 i 1968 godine,* Zagreb.

Pitić, G. (1989). "Karakteristike i organizacija spoljnotrgovinskog sistema Jugoslavije od 1918 do 1929", in: *Acta historico-oeconomica iugoslavieae*, pp. 109-123.

Rozenberg, V. V., & Kostić, J. L. (1940), *Ko finansira jugoslovensku privredu država - banke - inostrani i domaći kapital u službi privrede,* Beograd.

"Promene u potrošnji i proizvodnji tekstilija" (1934), in: *Glasnik zavoda za unapređivanja spoljne trgovine*, 4.

Sandberg, L. (2005), "Cotton since 1914", in: D. Jenkins, *The Cambridge History of Western Textiles.*

Stefanović, S. (1996), "Jedan neuspešan pokušaj državne intervencije u privredi Kraljevine SHS 1920 - Središnja zadruga za snabdevanje i izvoz AD", u: *Godišnjak za društvenu istoriju*, 1-2, pp. 95–108.

Svennilson, I. (1954). Growth and stagnation in the European economy, *Geneva.*

Anketa centralnog sekretarijata radničkih komora, (1936), *Tekstilna industrija i tekstilno radništvo u Jugoslaviji*, Beograd.

Алексић, Д. (2010), *Држава и привреда у Краљевини СХС,* Београд.

Беров, Л. (1989), *Икономика на България до социалистическата революция,* София.

Беров, Х. (2012). "Балканска индустријализација балканских 'Манчестера': Лесковац и Габрово (1878–1912)", in: *Годишњак за друштвену историју,* XIX (3), pp. 7-41.

"Вноса на текстилни материали и изделия въ България" (1929), *Известия и стопански архив на Министерството на търговията, промишлеността и труда, IX* (9-10), pp. 345-374.

Ђуричић, В. М., Тошић, М. Б., Вегнер, А., & П. Рудченко, М. Р. (1927), *Наша народна привреда и национални приход,* Сарајево.

Неделчев, К. Д. (1937), *Външната търговия на България 1920-1936,* София.

"Перспективите на цените на памук" (1929), *Известия и стопански архив на Министерството на търговията, промишлеността и труда,* IX, 11-12, pp. 456-466.

Ristić, I. (2012). "Diplomatsko-konzularna predstavništva i predstavnici Kraljevine SHS u Bugarskoj 1920-1929", in: *Arhiv, časopis Arhiva Jugoslavije,* 1-2, pp. 97-114.

Списание на Българското икономическо дружество (1934), *Списание на Българското икономическо дружество*, година XXXIII, 7, септ.

Стаинов, Г. (1937). "Проблемата за вълната", in: *100 години блгарската индустриа 1834-1937, начало, развитие и значение,* Софиъ.

Čalić, M. Ž. (2004). *Socijalna istorija Srbije 1815-1941,* Clio, Beograd.

Беров, Л. (1989). *Икономика на България до социалистическата революция,* София.

Неделчев, К. Д. (1937). *Външната търговия на България 1920-1936,* София.

Chapter 16

The History of Money in Montenegro from 1906–1918

Nikola Fabris*
E-mail: fnikola@ekof.bg.ac.rs

Abstract: Throughout its long history Montenegro has mostly used foreign currencies:, Roman, Austrian-Hungarian, Turkish, and Venetian money, and even the Napoleon (French gold coin). It was Bishop Petar Petrovic Njegos in the 19th century who first had the idea that Montenegro should have its own currency. The first Montenegrin money, the perper, was minted in 1906. King Nikola`s Decree of 11 April 1906 authorized the Ministry of Finance to mint nickel and bronze coins. Later silver and gold coins were also minted. The perper disappeared when Montenegro joined the Kingdom of Serbs, Croats, and Slovenians, bringing into circulation the dinar, the currency of the newly established state.

The paper analyses the history of money in Montenegro in the period 1906–1918, the importance of the introduction of a national currency, the influence on the development of the financial (banking) system, and the consequences of its withdrawal after World War I.

Key Words: Montenegro, Money, Perper, Financial System.

JEL Classification: E51, E40

1. INSTEAD OF AN INTRODUCTION – THE HISTORY OF MONEY IN MONTENEGRO

Money has had a long history and it is difficult to determine reliably when it first appeared first. Alexander the Great is usually credited with having created the first monetary system, followed by that of the Roman Empire.

The history of money in Montenegro reflects the turbulent history of the Balkans with its various influences and interests, and also the continuous striving of the Montenegrin people to independently choose their own fate.

Various currencies have been in circulation in Montenegro throughout the centuries - Greek, Illyrian, Roman, Venetian, Serbian, Turkish, - depending on which power was politically or economically dominant at the time.

* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179065) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

The oldest coin found in Montenegro dates back to before the Common Era, to the period of the Illyrian queen Teuta who fled to Risan after defeat by the Romans in 229 BCE.[1] However there is concrete evidence that copper and silver coins were minted in towns on the Montenegrin coast and its hinterland throughout the 2nd and the 3rd centuries BCE.[2] In Illyrian times, money was also minted in other towns, primarily coastal towns which had their own money, and Greek silver money had been in circulation inland. In the Middle Ages, Byzantine, Venetian, Hungarian, German, Turkish, and Serbian money circulated in Montenegro.

Under the tutelage of Byzantium in the 11th century CE, the mint in Kotor produced coins, and it maintained its operation when the Serbian Tsar Dusan conquered Kotor. The mint continued producing coins after the town has been conquered by the Venetians, who minted their money in Kotor until 1640.[3]

In the early 15th century the mint was set up in the town of Bar after it was conquered by the Turks. Throughout the Middle Ages coins were also minted in the coastal towns Ulcinj and Svac. The rulers of Zeta, the Balsici, also minted their coins in 14th and early15th centuries, and there were eleven types of money in circulation during their reign.

In spite of the fact that the coastal towns minted their own coins, Byzantine gold coins were in circulation for a long time. The Byzantine money was called perper, the name which was given to the currency of the first Montenegrin state. From the 16th century mostly Venetian money was in circulation in the coastal area, whereas the dinar and the dukat, and later on the Turkish akcha circulated inland. In the 19th century Montenegro joined the Austrian-Hungarian monetary sovereignty for economically practical reasons, and Austro-Hungarian currency stayed in circulation until the issuing of the first state money of Montenegro in the early 20th century.

The first ideas for Montenegro's own money came from the Bishop Petar Petrovic Njegos in the 19th century. It is assumed that he had the idea of minting the coins during his stay in Naples after meeting with Carl Rothschild, a banker and a financial magnate. An anecdote from that period tells that when Rothschild asked Njegos whether coins were minted in Montenegro, Njegos answered, "If stone could be minted, I would have started minting them long ago".[4]

Under the influence of Rothschild, a mould for minting coins was purchased and brought to Cetinje (the then capital of Montenegro) in 1851. However, no evidence that coins were actually minted has ever been found, only a wax impres-

1 Šekularac (2007), p. 15.
2 Radunović (2007), p.44.
3 Šekularac (2007), p. 17.
4 Martinović, (2007), p.227.

sion of a perun coin, the currency named after the supreme Slavic deity. However, where the Bishop failed King Nikola later succeeded.[5]

2. MONEY IN MONTENEGRO FROM THE BEGINING OF THE 20TH CENTURY UNTIL WORLD WAR I

The first European central banks were founded in the 17th century through an evolutionary process as a result of the demands of wars on state finances. The central bank usually emerged by separating one of the so-called 'privileged' banks, which received the concession for issuing national money.[6] Most of the first central banks were private institutions. Only eighteen central banks existed in the world at the beginning of the 20th century. The number of central banks drastically increased when colonies gained independence and when former socialist countries disintegrated.

There was no central bank in the Principality and the Kingdom of Montenegro. Crnogorska Banka in Cetinje was established with the idea that it should be the central bank, and the National Bank for the Principality of Montenegro received the concession to issue national money. However, this was not put into effect in practice. The instruments of the monetary authority remained in the hands of the state authorities.

The Austrian florin was the main money in Montenegro in the second half of the 19th century. The florin was the official means of calculation until 1 May 1901 when the Austrian krone was introduced. At that time Montenegro was an underdeveloped country in which ownuse production was dominant, with small market surpluses. The most intensive original accumulation of capital was performed in trade. The crucial moment in the development of trade in goods and trade capital was the inclusion of the newly liberated cities and towns in the Montenegrin state after the Congress of Berlin. Trade was substantially more developed in Podgorica, Nikšić, and Bar, which until then had been part of the Ottoman Empire, than in the rest of Montenegro. Industrial capital started to develop only at the beginning of the 20th century and had a marginal role. On the eve of World War I there were only a few large industrial facilities - a tobacco factory in Podgorica and two breweries in Niksic - and some smaller industrial units. There were also two printing companies.

However, the development of trade in goods and the increase in trade capital created a growing need for money. Accordingly, at the beginning of the 20th centu-

5 The programme for minting Montenegrin money was prepared for the celebration of the bicentenary of the Petrovic Dynasty on the Montenegrin throne (1897), but it did not come to pass because the Austro-Hungarian Empire was not comfortable with the idea of Montenegro being monetarily independent.

6 Fabris (2006.), p.32.

ry, banking capital appeared, i.e., modern forms of credit relations, which gradually abolished usury. The first bank in the Principality of Montenegro was founded in 1901 as Prva nikšićka štedionica. That same year, beyond the borders of the former Montenegro, Bokeška banka was founded in Kotor. Three years later, Prva zetska štedionica was established in Podgorica. In subsequent years another two banks were established as the issue of money and the monetary system became increasingly important.

Austrian money circulated without any compensation as if Montenegro were a part of Austria-Hungary. In the political and economic circumstances of that time, the functioning of foreign currency had a series of negative consequences. Consequently, at the end of the 19th century, Montenegro sought to issue its own currency. Vukovic, the Minister of Foreign Affairs, announced to the Austro-Hungarian envoy in Cetinje that Montenegro intended to mint gold and silver coins. In order to have equal circulation of Montenegrin money in the territory of the Austria-Hungary he suggested a Monetary Convention to help resolve the issue of the mutual circulation of the two currencies.

There was no response, and so Matanovic, the Minister of Finance, was designated to negotiate with Austria-Hungary. The idea was to mint mostly coins of nickel and copper and smaller amounts of silver and gold coins. Although Austria-Hungary originally accepted this suggestion it soon changed its mind, believing that it had no need to sign a monetary convention with a small country such as Montenegro.

As Vuković pointed out in his memoirs, all that the Austrian-Hungarian government agreed was that "Montenegro could mint its money in government mints at its own risk, for its account, at its expense and exclusively for its use. Austria will not officially ban the use Montenegrin money, but state vaults and banks will not accept it under any conditions".[7]

Since a large number of foreign currencies such as krone, talirs, Napoleons, and roubles were in circulation at that time, this system created numerous difficulties. The former Montenegrin Consul in Shkoder, Jovan Vaclik, proposed to Prince Nikola the minting of Montenegrin coins in 1902. He suggested that Montenegrin coins should be minted in the "Russian monetary castle in Petersburg", from the funds that Montenegro obtained as subsidies from Russia. Instead of paying subsidies in roubles, Vaclik suggested minting Montenegrin coins gradually over four years in St. Petersburg and sending them to Montenegro.

By the Decree of Prince Nikola of 11 April 1906, the Ministry of Finance was authorised to mint nickel and bronze coins to the amount of 200,000 krone (209,000 krone was minted in the end).[8] Even though the idea was that the coins should be minted in Paris and in Russian mints, in the end it was minted in Vienna. Nickel

---

[7] Vuković (1985), p. 29.

[8] Glas Crnogorca (1906), no. 15.

and bronze coins were released into circulation on 28 August 1906. Simultaneously the value of Montenegrin and Austrian coins was equalised, 100 para to 100 hellers, i.e., 1 krone. Small Austrian coins were replaced in this way and customs offices were ordered to replace Austrian money by 15 October 1906 and exclude it from circulation by 1 January 1907. However, due to a lack of small coins, Austrian money still remained in use in Montenegro. In 1908 a new issue of coins was minted to the value of 110,000 krone.

The total value of Montenegrin money in circulation amounted to 319,000 krone and was insufficient. Gold coins of various countries such as the U.S. dollar, the French Napoleon, the deutsche mark, the English pound, the Russian rouble, and the Turkish lira were also in circulation. In such conditions the monetary sovereignty of Montenegro was limited.

Based on the initiative of Jovanović, the Minister of Finance, the idea was to mint a new currency, the perper. It was supposed to be minted as silver and gold coins. Originally, it was planned to mint it in Vienna, but due to the deterioration of political relations caused by the Annexation crisis, Montenegro turned to Serbia. The Serbian National Bank, through its financial institution, provided the loan and paid the necessary funds to a Parisian bank (Banque de Paris), as the French Minister of Foreign Affairs agreed to mint the coins. On 4 May 1909 Prince Nikola passed a Decree on the issue of silver coins. This Decree mentioned the name of Montenegrin money for the first time: perper. Silver coins to the amount of 800,000 perpers were released, corresponding to the value of 800,000 silver krone.

The next issue of money was in March 1910 when gold coins were minted for the first time. 1,030,000 gold and 600,000 silver coins were minted to the value of 1,630,000 perpers. This time the coins were minted in the Vienna mint because of the poor quality of coins from the Paris mint. In 1910 there was another issue of coins and 1,000,000 perpers were released in circulation, and a special commemorative gold coin was minted. in Vienna to celebrate Prince Nikola's fifty years of rule.

The state treasury did not benefit from the minting of coins, which primarily had a political function, i.e., the reduction of dependence on Austria–Hungary. As Djurović pointed out, the first issue of gold coins resulted in a loss of 7109.58 perpers, and the second commemorative minting a loss of 10064.55 perpers.[9]

With a view to completing the monetary system, the Law on State Money of the Kingdom of Montenegro was passed in December 1910 and came into effect at the beginning of 1911. The law prescribed that Montenegro "shall adopt in its territory gold currency for monetary traffic, which monetary unit shall be Perper". This law also determined the shape and the signs on the reverse and obverse sides. The law prohibited circulation of foreign currencies in the territory of Montenegro, which was probably its most important decree.

[9] Djurovic,(1960), p. 68.

The law had positive effects: it removed from circulation the Austrian silver and small nickel and copper coins, had a positive financial effect on the state treasury, and provided a domestic currency that had the full confidence of Montenegrins, reduced dependence on Austria-Hungary, and strengthened political independence.

Although Austria-Hungary did not recognise Montenegrin money, the currency, and in particular the gold coins, also circulated in Austria-Hungary, due to the important trade relationships between Montenegro and the Empire. In time mutual trade created more favourable conditions to regulate monetary issues on the basis of reciprocity. The monetary negotiations that had been going on for 15 years were completed on this basis in the middle of 1911 and came into effect on 21 September 1911. Based on this convention, the circulation of perper was allowed in Austria-Hungary so that "gold coins were accepted at face value for customs payments in all Austrian-Hungarian customs offices, and for postal payments in Vienna, Trieste, Budapest, Zagreb, Rijeka and Sarajevo, as well as with all state treasuries authorised to accept gold coins".[10] The convention limited circulation of Montenegrin money, in particular nickel and bronze coins, but the circulation of Austrian money in the territory of Montenegro was also limited on the same basis. This was a huge political success for Montenegro since the implementation of the reciprocity principle had been achieved, and Montenegrin and Austrian money was equalised.

However, foreign outflows and hoarding resulted in a permanent decline in Montenegrin gold coins. In 1912 only silver coins were minted. The law envisaged minting of silver coins to the value of 800,000 perpers. However, only 300,000 perpers were minted. The following table shows the amount of coins minted by year.[11]

Table 1 – Minting of Montenegro's coins

Year	Value of minted coins
1906	209,000
1908	110,000
1909	800,000
1910	2,630,000
1912	300,000
1913	71,000
1914	1,250,000

Source: Borozan, Dj. (2007), Kovanje srebrnog i zlatnog perpera i pitanje monetarne konvencije izmedju Crne Gore i Austrougarske, Obod, Cetinje

Counterfeits soon appeared, particularly of the silver coins. The Minister of Finance issued a description of the counterfeit money and instructions for recogniz-

[10] Borozan (2007), p. 49.

[11] The government planned to mint coins in Paris in 1915, but was prevented by the war. However there exist coins from this issue imprinted "ESSAI", French for "trial".

ing it in the newspaper Glas Crnogorca (No. 13 for 1910). Excellent counterfeits of gold coins have also been detected (20-perper denominations) made of equally fine gold as the original coins but weighing 6.65 grams instead of 6.78 grams.. The assumption is that these gold coins originated at a substantially later time and they were intended for collectors, due to the extremely high price the perper had in that market.

However, the political situation in the Balkans was complicated. Montenegro was preparing for the First Balkan War, which significantly burdened public finances. Therefore a law on issuing treasury notes was passed in 1912, so that treasury bills were issued as the first Montenegrin paper money, which was guaranteed by the state up to its face value. It was envisaged that it would be in circulation for only a year, but as Montenegrin finances were exhausted this deadline was extended until 1 February 1914, and in practice the withdrawal of treasury notes was delayed for several more months. There was a second issue of treasury notes in 1914, and a final issue in December 1915. All issues had a limited circulation period.

3. WORLD WAR I AND ITS IMPLICATIONS

At the beginning of 1916 Austria-Hungary occupied Montenegro and assumed governance of the monetary system. The disbursement of paper money was stopped but the occupying authorities decided to keep it in circulation, although with an Austrian seal imprinted on it. There are no data available on how much of the original issue of perper was verified in this way, but Novaković puts it at one third..[12] Worn paper banknotes were exchanged for new 10-perper notes whose issue was authorised by the Austro-Hungarian Military Governor General. This was the last money released in circulation based on the Law of the Kingdom of Montenegro but under the conditions set up by the occupying authorities.

With the emergence of the Kingdom of Serbs, Croats, and Slovenes, the perper disappeared. Perper coins were exchanged at a rate of 1 dinar to 1 perper. Since no gold coins of the Kingdom of Serbs, Croats, and Slovenes existed in that period, it was more cost-effective for the holders of perpers to negotiate the perpers for gold rather than to exchange them for dinars. The exchange rate was 5 perper banknotes to 1 dinar banknote. The perper was around 10% stronger than the dinar before the unification. Perper banknotes were excluded from circulation from the middle of 1919. The dinar increasingly devalued over time: in 1919 1 U.S. dollar was worth 10 dinars; two years later 1 U.S. dollar was worth 100 dinars. This devalued the value of the perper even more.

Another discriminatory decree was passed in the middle of 1921, which said that 1 perper coin would be exchanged for 1 dinar for those who had 5,000 per-

[12] Novaković (2006), p.326

pers, while those who had over 5,000 perpers got 2 perpers for 1 dinar. The perper constituted only 0.5% of the total money supply of the Kingdom of Serbs, Croats, and Slovenes.[13]

Almost two thirds of perper coins were never replaced, resulting in an insufficient amount of money in circulation which reflected negatively on the work of financial institutions, banks, and savings banks in Montenegro and resulted in rising prices. Thus World War I had a negative effect on the development of the monetary and financial system in Montenegro. The poor were affected most and were even more impoverished by having to exchange perper banknotes at a discriminatory rate. This politically motivated policy produced much discontent in Montenegro.

Montenegro used the dinar as its currency until 1999, when on 2 November a dual currency system of the dinar and the deutsche mark was introduced. At the beginning of 2001 the deutsche mark became the only legal tender until the euro became the legal tender in March 2002.

4. CONCLUSION

Different foreign currencies were in circulation in Montenegro until the beginning of the 20th century. These were mainly currencies of the various conquerors and most powerful economic forces at the time. The idea of minting the first Montenegrin money came from Njegoš, but the idea was realized by King Nikola I, despite opposition from the Austro-Hungarian monarchy.

Nickel and bronze coins of small value were minted first in 1906, in 1909 silver perpers were minted, and a year later, in 1910, gold perpers. Paper money was printed for the first time two years later.

The Kingdom of Serbs, Croats, and Slovenes was created as a consequence of World War I. Montenegrin money disappeared as a result of the emergence of the new state. It was exchanged at a discriminatory rate so that the coins were sold as gold. This resulted in a decline in the amount of Montenegrin money in circulation and aggravated conditions for the development of banks, savings banks, and financial institutions. Since the dinar progressively devalued over time, the holders of perper currency were even more affected, the poor in particular. Therefore it can be concluded that World War I had an indirect negative impact on economic and financial development and the social situation in Montenegro.

[13] Novaković (2006), p.334.

REFERENCES

Borozan, Dj. (2007), Kovanje srebrnog i zlatnog perpera i pitanje monetarne konvencije izmedju Crne Gore i Austrougarske, Obod, Cetinje.

Djurović, M. (1960), *Crnogorske finansije 1860-1915*, Obod, Cetinje.

Fabris, N. (2006), *Centralno bankarstvo u teoriji i praksi*, Centralna Banka Crne Gore, Podgorica.

Fabris, N. (2008), "Implication of Dollarization with a Special Overview of Montenegro", *Les Cahires de Recherche*, no. 11, Pp 3-31.

Službeni organ Knjaževine Crne Gore (1906), "Glas Crnogorca", 15. april 1906, no. 15, Cetinje.

Martinović, B. D. (2007), "Planovi za kovanje crnogorskog novca", in Radunovic et al. (ed.) (2007), *Novac u Crnoj Gori,*, Državni arhiv, Cetinje, Pp 223-233.

Novaković, P. (2006), "Perper", in Radunovic et al. (ed.) (2007), *Novac u Crnoj Gori,* Državni arhiv, Cetinje, Pp 337-352.

Radunović, S. (2007), "Antičke kovnice novca na teirotriji Crne Gore", in Radunovic et al. (ed.) (2007), *Novac u Crnoj Gori,* Državni arhiv, Cetinje, Pp 58-63.

Šekularac, B. (2007), "Razvoj crnogorske numizmatike", in Radunovic et al. (ed.) (2007), *Novac u Crnoj Gori,* Državni arhiv, Cetinje, Pp 11-25

Vuković, G. (1985), *Memoari*, Obod Cetinje.

Chapter 17

Exploring the Development of Audit Practice Through Critical Events: Lessons Learned and Not Learned

Miroslav Todorović*
E-mail: todorovic@ekof.bg.ac.rs

Savka Vučković Milutinović**
E-mail: saska@ekof.bg.ac.rs

Abstract: Audit practice in Serbia is facing the same problems it has had since its infancy, and they are only dealt with once they have become big. When auditors are unable to satisfy requirements this leads to disappointment and results in an expectation gap. In an effort to narrow the gap, over time auditors have changed both audit practice and objectives. In line with the theme of this conference, in this paper we discuss the lessons to be learned from the development of audit in the period around the First World War. We discuss general guidelines for narrowing the current expectation gap and recommendations for future practice in Serbia. Auditors must take responsibility, learn from past mistakes, and face the fact that failure to recognize changing demands and external events will do serious and perhaps irreparable damage to their profession.

Key Words: Audit Practice, Audit Objectives, Expectation Gap, The First World War, Economic Crisis

JEL Classification: M420

1. INTRODUCTION

In comparison to current auditing, audit practice was poorly developed in the early 20th century. Nevertheless, studying the way in which the profession responded to the demands of that time, in different countries and to different external events, can help reach some conclusions which could support framing the auditing in the future.

* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179050) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

** Faculty of Economics, University of Belgrade

In the period before the First World War (WWI), except in Britain and the United States, real audit of financial statements was either unknown or poorly developed. In the period after WWI until the Great Depression there was moderate development of audit in the UK, the U.S., and other leading countries, primarily Germany and France. Even then audit practice faced many challenges when trying to adapt to the expectations of the public and users of financial statements. Unmet expectations lead to public distrust and create an expectation gap. The American Institute of Certified Public Accountants (AICPA) defines the expectation gap as "the difference between what the public and financial statement users believe auditors are responsible for and what auditors themselves believe their responsibilities are".

Whether there is an expectation gap must be judged from the perspective of the time. In the UK before the 1920s the usual 'bookkeeping audits' were not seen as a problem, whereas today they would be interpreted as a serious problem in terms of auditor independence. According to the observation by Matthews (2006) who summarized the results of some previous research and the interviews, the professional community did not have anything against that. Matthews presented allegations of scientific papers and books of the time where it can be seen that bookkeeping audit was elaborated as wide-spread, common and normal practice.

In this paper we first examine the important drivers of the development of audit from the period before WWI through the period after WWI to the Great Depression, hoping to draw some important lessons for future audit design and practice. By comparing the challenges then and the challenges auditing practice faces today, we will present some conclusions as to the future development of audit practice, with a special focus on Serbia.

2. AN OVERVIEW OF THE DRIVERS OF AUDIT DEVELOPMENT PRE-WWI

In this section we focus on an overview of the important drivers of audit in the most developed countries pre-WWI. The UK was the most advanced in the development of audit and the USA and France to a large extent followed British practice.

Although it is commonly argued that the biggest event in the development of the professional audit of financial statements was the appearance of joint stock companies, a careful review of the development of audit in the UK shows that this was not the case. Even making audit compulsory by law was not an important factor in the development of the modern audit: the most important events were the appearance of large-scale fraud in corporations, primarily railroads, and the development of the accounting and auditing profession, i.e., the existence of auditors with accounting knowledge.

Some historians of accounting and auditing have tried to detect audit practice in 17th century corporations, but what they found does not resemble what we now consider an audit of financial statements. However, disappointments with the so-called auditors then led to the development of audit in the modern sense of the word. Thus, the modern audit was provoked by a kind of expectation gap of that time.

In 1844 auditing became mandatory for public joint stock companies by enacting Joint Stock Companies Act. Although the practice was present earlier, this Act made it compulsory for shareholders of public joint stock companies to choose one or two 'shareholder auditors' from among themselves at the half-yearly shareholder meetings. A sufficient qualification for appointment as auditor was owning only one company stock. The expectation that those with an ownership interest in a corporation would be best for checking the accuracy of the annual accounts was quite reasonable. However, the fact that no professional qualification was needed meant that these amateur auditors were unable to carry out a complete audit of financial statements. Even though from today's perspective these amateur audits were "a complete farce" and "destitute of all efficiency" (Glynn, 1984), this practice was maintained for almost 30 years. Amateurs typically confirmed the financial statements as they were presented, so audits were facetiously referred to as "biscuit and sherry audits" (Robb 1992, p.129). The meaninglessness of such shareholder audits, coupled with the sudden popularity of the concept of laissez-faire, was the likely reason for the 1856 law regulating Joint Stock Companies to waive the requirement for compulsory audit. Finally, the introduction of the Limited Liability Act in 1855 eased the position of shareholders, in the sense that they had less to lose if their company went into liquidation, which decreased the importance of auditing. The expectation gap increased with the development of the railways, which attracted hitherto unprecedented amounts of capital from a large number of 'blind' investors, resulting in huge fraud. In the last twenty years of the 19th century the fact that amateur auditors were unable to detect these frauds was an important driving force behind the rapid development of external audits. Thus, amateur auditors increasingly hired external professional accountants to help them do the job that they themselves were unable to do. Before 1883 all railway company auditors were amateur, but by 1890 almost all of the companies had professional auditors or a combination of amateurs and professionals. Before 1886 almost three-quarters of public companies were professionally audited by members of the Institute of Chartered Accountants in England & Wales (ICAEW), although the audit was not legally required; by 1890 12 of the 13 steel companies that were going public elected chartered accountants as their first auditors (Matthews, 2013, p.11).

Although by far the most advanced audit practice was developed in the UK, from today's perspective a good part of the activities performed by the then external auditors is problematic. Most companies expected the auditor to close the books, draw up a trial balance, produce a profit and loss account and balance sheet and then give an opinion on them in an audit report. Such audit practice is popularly called a 'bookkeeping audit'. Very few companies expected a 'pure audit'. Interestingly, the apparent lack of auditor independence that resulted from the practice of bookkeeping audit was not seen as a problem. The Companies Act of 1856, although very loosely worded and liberal in terms of how companies should present financial statements and how they were to be audited, clearly distinguished between the directors' responsibility to produce a balance sheet and the auditors' job to give an opinion on it. The Act also clearly stated that audit should be done by external auditors, which created a market for professional auditors and introduced the concept of independence (Higson, 2003, p. 92). However, as Matthews (2013, p.12) said, there was a kind of conspiracy of silence in regard to the symbiosis of accounting and audit work, and 'doing the books' was regarded as something desirable. De Paula (1922, p.3) stated that "In practice, auditors often do prepare the Balance Sheet and Profit and Loss Account, which accounts they thereafter certify; but it must be observed that, when preparing the accounts, the accountant is acting *qua* accountant and not *qua* auditor, and that this work is additional to and quite outside his duties as auditor."

The reason why the auditors did accounting work was that their clients did not have enough staff to do the job themselves. In the UK in 1890 only every hundredth company had a qualified accountant, and the situation did not significantly improve until 1911 (Matthews, 2013, p.18). The simple conclusion is that proper auditing needs proper accounting, and if there is no qualified personnel in company accounting departments, then independent audit is impossible.

Even though it appears that the state understood the importance of auditing in the UK, the government had not contributed much to the development of the audit. As stated above, soon after the introduction of mandatory audit in the Joint Stock Companies Act 1844, the Joint Stock Companies Act of 1856 removed provisions that made audit compulsory, and it was almost fifty years before audits were made mandatory again in the Companies Act of 1900 (Day, 2000). However, in contrast to other European countries, the British government had already done much for the development of the audit by recognizing accounting as a profession and awarding the Royal Charter to the Institute of Chartered Accountants of Scotland in 1854 and to the ICAEW in 1880.

In USA early development of auditing was with some time lag in comparison with British practice, but in the last decade of 19th century demand for auditing was already steadily present. First American auditors were primarily interested in finding irregularities and dedicated to their stewardship role for providers of capital, but this soon changed to verification of financial statements due to a rapid increase in company size. At the turn of the century there were many industrial mergers creating big corporations with widespread ownership, which became characteristic of the American economy. Auditing services were first supplied by accountants from the UK, but thanks to the transfer of knowledge American practitioners made quick progress. Some big accounting firms, for example, Price Waterhouse, were formed in the 1890s or during the first decades of the 20th century.

In 1887 the first professional association, predecessor of todays AICPA, was established. From its beginning the association was dedicated to the prosperity of the profession and soon (in 1896) it achieved legislative recognition as a profession in New York State when a law was passed "To regulate public accountants". This was undoubtedly a critical event that provided a good basis for further development of the profession. At the end of the first year after it was founded the Association had 32 members and in 1908 there were around 400 (Roberts, Cannon, 1987). At that time no authoritative accounting or auditing principles or guidelines existed. Some progress in providing technical assistance to practitioners was made in 1892 when the first audit manual was published by Dicksee, called Auditing: A Practical Manual for Auditors. The certification exam for the qualification of Certified Public Accountant was initiated in 1896.

In the examples of the UK and USA we have seen market-driven development of the audit. Although at that time it was non-obligatory, auditing evolved as an important monitoring device in corporations of the Berle and Means model, in which small dispersed investors were powerless to carry out effective monitoring of managers. In other countries, even in France and Germany, significant market demand for audit simply did not exist, and governments had not realized the need to impose audit in order to protect the public interest.

In Germany and many other countries in continental Europe companies were not significantly relying on the funding from financial markets, but on the banks. Continental corporations never fitted the Berle and Means' model of diffuse ownership. Unlike the USA and UK, in the majority of German companies there was no significant conflict of interest between, on the one hand, a large number of dispersed owners, and on the other hand 'entrenched' managers who controlled the company without ownership or with only a small ownership share. Possessing a significant share of the ownership internalizes the benefits of monitoring management, since the owner then has sufficient control to take an active role in the corporate governance by selecting a management team, or being senior manager himself (Edwards, Nibbler, 2000). Control over managers in the continental model was provided by much stricter statutory and legal limitations. The controlling owner meets the information needs in a company directly and consequently the incentive for extensive public disclosure of information and auditing is weak. This, of course, harms the interests of minority shareholders, whose information needs remain unmet. In the absence of legal protection, minority shareholders were also punished in another way. Due to the high concentration of ownership and companies' unwillingness to raise capital from the financial markets, the financial market was less developed, which made it difficult or impossible for minority shareholders to exit investment (a quick sale of stocks realizing the 'full' price). Thus, in modern terminology, in the continental model the agency problem between managers and shareholders is not expressed, but is substituted by an agency problem between controlling (large) shareholders and minority shareholders. In more practical terms, this means that the danger of the manager extracting private benefits of control is replaced with the problem of the controlling owners extracting private benefits of control at the expense of minority shareholders. A controlling owner could extract private benefits of control relatively easily trading at 'non-market prices' with 'his companies' through ownership pyramids or in cross-ownership structures (popularly: tunnelling), by further dilution of minority ownership achieved by new stock issues that minority shareholders cannot absorb, etc.

According to the laws in Germany in this historical period, the supervisory board (Aufsichtsrat) played the most important role in monitoring management and its role was to audit company accounts. The law of 1861 (Allgemeines Deutsches Handelsgesetzbuch) introduced a voluntary supervisory board, but the next law of 1870 (Gesetz betreffend die Kommanditgesellschaften auf Aktien und die Aktiengesellschaften) made the supervisory board compulsory. It had to consist of at least three members selected from the shareholders (Evans, 2003). There is an obvious similarity with early auditing practice in the UK, in that auditing was conducted by shareholders. This practice caused the same problems regarding quality of audit, due to the amateur auditor's lack of professional knowledge. The purpose of audit was also jeopardised by the auditors' lack of independence, as they were often included in management activities. The law of 1884 made some progress in that it made auditing of the company formation process obligatory. It also gave minority stakeholders the opportunity to demand the appointment of external auditors to examine financial statements, with a requirement of 10% ownership for this action to be possible (Evans, 2003). However, minority shareholders rarely marshalled sufficient support to meet the ownership percentage requirements (Harston, 1993).

A specificity of Germany was that banks actually controlled large companies, which according to some authors (La Porta et al., 1999) is still current practice. The Law of 1884 opened a door for expanding the role of banks through increasing minimum capital requirements for the corporate form of business. Banks became both creditors and owners of corporations and their relationship with corporations was very strong. They had access to all the necessary information and perceived external audit as harmful to their interest rather than useful. Harston (1993) concludes that bankers "feared losing control of management through disclosure and external audits". She also explains that auditing threatened the practice of creating secret reserves, which banks favoured for numerous reasons (for instance, limitation of profit distribution to minority shareholders, and protection of their own investments).

Calls for mandatory audit appeared at the turn of the century as a result of company collapses and bank failures. However, these calls were muted in banks, which reacted by founding audit companies (Treuhandgesellschaften) in which they were major stakeholders, and so controlled the companies. The first company of this kind, Deutsche Treuhandgesellschaften, was founded in 1890 by Deutsche Bank as a trust company, but soon entered the auditing business. In 1903 Deutsche Treuhandgesellschaften conducted 27 external audits and by 1907 this number had risen to 400. Other banks also founded their own audit companies and by 1914 there were 14 such companies in Germany (Markus, 1997). The quality of auditing performed by these first auditing firms was very questionable since these firms were not independent from the banks: often the external audit was not 'external' at all. Because of the prevalence of ownership relations between corporations and banks through cross-ownership or pyramids, the auditing firm and the audit clients were in many cases related parties.

An alternative course in the development of the German auditing profession was the activities of 'book examiners' (Bücherrevisoren), who initially had worked for courts as expert witnesses and then began to offer services in different areas, including auditing company accounts. Their qualifications were not standardised and prerequisites for working as a book examiner were almost non-existent. Many practitioners had low expertise, which ruined the reputation of the whole examiner profession.

Although auditing was present in some form in Germany in the period before WWI, as indicated above the scope of audit was pretty narrow and dependent on the requirements of the supervisory boards. Markus (1997) explored the wording of auditors' reports and concluded that it was common for auditors to address "agreement of accounting records with financial statements". In a few cases there was the phrase "the accounting records were properly kept", which could suggest that the audit work expanded somewhat.

3. AN OVERVIEW OF THE IMPORTANT DRIVERS OF AUDIT DEVELOPMENT FROM WWI TO THE GREAT DEPRESSION

After WWI, British auditing practice continued to develop steadily, based primarily on strong demand for accounting services, a strong juncture between accounting and auditing, and the rapid growth of accounting partnerships that developed specific methodologies tailored to the needs of clients. Confidence in the quality of audit services was high, even though bookkeeping audit was still very present and the quality of financial reports was questionable. The number of qualified accountants was still very low – there were only 6 qualified accountants in total per 100 companies and only 38 per 100 public companies (Matthews, 2013, p.18).

Again, critical events were needed to push the profession further. The lack of generally accepted accounting and auditing guidelines was a serious threat to the profession, but this shortcoming did not attract attention until the appearance of new company collapses. Day (2000) notes that in the early 1920s companies faced difficulties due to the economic recession, which caused a decline in their reporting practices. They used secrecy in order to avoid having to communicate unpleasant information about the companies' condition, but somehow the profession tolerated that. A very popular accounting device for this purpose was secret reserves. Although the creation of secret reserves could in some sense be justified in order to protect creditors and improve dividend payment stability, they could also be used to deceive shareholders. The misuse of secret reserves culminated in the case of the Royal Mail, which hid its losses for a few years by revealing previously formed reserves. The auditor in this case was accused, but the consequences for the whole profession were far-reaching. Chandler et al. (1993) indicate that both accounting practices and the role of auditor were strongly criticized. It was an important event, which led the profession to start discussing ways of improving the credibility of financial statements. In the next decades the USA took the lead in improving accounting and auditing practices.

During and after WWI, tax issues became very important in the USA. Companies were forced to pay income tax and tax rates tended to rise. These circumstances created an opportunity for the accounting profession to broaden its services to taxation, which further strengthened the position of professional accountants. They were able to offer array of services (tax, management consulting) in conjunction with auditing. During WWI accounting firms were often hired to evaluate the efficiency of war-related manufacturing companies, which was the beginning of their engagement in auditing. Even then it was argued that the independence of the external auditor could be threatened by performing these other services for audit clients (Bloom, 1994).

Nevertheless, the auditing of financial statements remained an important service and developed further. In this period an increasing number of companies recognized the importance of audit, but the significant impetus for its further development came from regulatory bodies. In 1917 the Federal Reserve Board together with the Federal Trade Commission made an agreement with the professional association of accountants to publish a bulletin on auditing procedures. Their motivation came from their belief in the benefits of auditing. The Federal Reserve Board emphasized the importance of audited financial statements for the banking industry when supplying credit to unknown borrowers, while the Federal Trade Commission perceived the benefits of uniform accounting. As a result of this initiative the first authoritative guidance on auditing procedures was published in the USA (Zeff, 2003).

In the 1920s auditing firms increased their business enormously. This is best illustrated by the growth of Arthur Andersen & Co. In 1920 Arthur Andersen & Co. had two partners and fifty-four employees and by 1930 the number of partners had increased to seven and the number of employees to three hundred and seventy-eight (Arthur Andersen and Co., 1974, p.17). This impressive progress was primarily due to non-auditing services, as auditing was still voluntary. Although it was not uncommon for big companies to issue audited financial statements, the quality of financial statements and quality and frequency of auditing was not good enough to prevent the presence of misleading statements. Bloom at al. (1994) explained that in a "casino" environment where investment fever prevailed, many investors' decisions were actually based on "rumors and innuendo". The Great Depression was another critical event that raised the interest in audits. The securities laws of the early 1930s made auditing mandatory for corporations issuing securities for public trading. Wooton and Walk (1990) conclude that these laws assured a market and prestige for the profession, and also enlarged its responsibilities: "not only did accountants have a social responsibility to the public, but they now had a potential legal liability to that public as well."

As mentioned, the relatively late development of a true audit of financial statements in Germany and France, especially in comparison to the UK, can be attributed to the existing model of capitalism and corporate governance and poor development of the accounting profession. In France, in the absence of market-driven incentives for the development of audit practice, the number of practitioners was too small to receive attention from the state. In the period around WWI several associations of accountants were created (e.g., 1912 Compagnie des experts-comptables de Paris), but they were unable to get treatment from the state comparable to that of professional institutes in Britain. It could be argued that the government lacked understanding; fiscal reforms and the introduction of income taxation had stepped up the demand for services and resulted in a flood of 'experts' of all kinds, but the government had not supported associations of accountants. As Ramirez (2007) said, French auditors were individuals, not member of professional partnerships in the Anglo-American sense, were poorly paid, had a "parochial" practice (i.e., local and personal), and the work that they were doing could be described as perfunctory control. Perhaps the most important event in the development of modern auditing of financial statements in France was the opening of the first offices of the British audit firms: Price Waterhouse in 1917, and another four by the end of 1920. However, their clients were subsidiaries of Anglo-American parent companies and there was a reoccurring problem of finding 'quality' staff locally, so they were mostly expats, mainly from Britain (Ramirez, 2007).

In Germany, the rapid development of audit in the interwar period was triggered by corporate fraud, the consequences of the war, numerous economics problems, and tremendous economic crisis. During WWI the credibility of financial statements was considerably impaired. The misleading presentation was mainly achieved due to the creating of hidden reserves in order to avoid reporting of increased war profits. When it became obvious that many companies were involved in these practices, public concern about accounting intensified. The case of the Daimler Company, whose statements were manipulated through fraudulent costing, attracted a lot of attention (see Gallhofer, Haslam 1991). Without compulsory and sound auditing these manipulations could not be prevented.

After WWI Germany faced numerous economic problems such as shortage of capital, hyperinflation, and increased poverty. The necessity for economic reform was obvious. In this context better monitoring of companies' affairs was of significant importance. Company failures uncovered the shortcomings of supervisory boards in their audit function and contributed to a greater demand for external audit. The trend towards external audit was reinforced by the influx of necessary foreign capital. Foreign investors, mainly from the UK and USA, wanted well-known assurance in respect of companies reporting. Some foreign auditing firms extended their business to Germany, but the domestic auditing profession also made progress. By the late 1920s auditing had developed from formal to substantial (Evans, 2003). However, the disunity of the profession, which acted through several (often conflicting) organisations, diminished its capability to improve its status through sound self-regulation or state regulation.

The bankruptcies of the late 1920s finally triggered the introduction of mandatory annual external audits. One of Germany's largest insurance companies, FAV-AG, collapsed just two months after it had presented accounting statements at its annual general meeting showing a profit of 3.1 million RM and a 12.5% dividend on the nominal value of its shares. This led to great concern regarding accounting rules and audit requirements (Quick, 1990).

The discussion about the significance of audit and the need for mandatory audit always happened during economic crises and massive bankruptcies, first in the 1870s, then in 1900-1903, and finally in the late 1920s. In stable environment it was not the case and regarding different characteristics of German economy agency problem itself was not sufficient incentive for developing of auditing. In 1931, through presidential decree, auditing became obligatory for all large corporations, rules regarding auditing were initiated, and a controlling body for the German auditing profession was founded. Harson (1993) concludes, "the German government could no longer continue a hands-off approach. Secrecy no longer functioned to maintain stability but had resulted in financial collapse. Independent monitoring became mandatory to protect the nation". By that time the profession, with the help of academics, had also consolidated its position by establishing an association for all practitioners, the Institut für das Revisions und Treuhandwesen (later the Institut der Wirtschaftsprüfer, which is still active).

The examination of audit history in other European countries also reveals valuable lessons. Economic crisis provoked mandatory audits in Germany as a monitoring device that would help to prevent company failure. By this time the experiences of other countries had already proved that introducing a mandatory external audit had not been sufficient if it had not been based on appropriate professional standards and regulative. In Sweden, as in the in UK, mandatory audit was requested by law of an earlier date, precisely since 1895. In the following decades the profession and the regulations developed, but the key event for auditing was the crash of the Kreuger Group in 1932, which shocked Sweden. The auditor of this group was "on the Kreuger payroll and he signed the audit's report without even performing an audit" (Öhman, Wallerstedt, 2012). After this crash the independence of auditors was perceived as essential.

4. LESSONS LEARNED FOR THE FUTURE DEVELOPMENT OF AUDIT

4.1. Expectation gap in light of the recent economic crisis: old and new answers

It is obvious from the above discussion that the expectations of auditing were always huge. The profession answered these expectations by trying to improve the quality of its work. Sometimes the changes were evolutionary and sometimes radical. The development of auditing procedures, auditing standards, and requirements for the members of the profession were evolutionary, while radical changes were provoked by unfavourable public reaction towards auditors and their profession, particularly in the case of bankruptcies of large companies that had previously received unqualified auditor opinion. In most of these cases the auditors did not consider themselves guilty, which means that the expectation gap was dramatically high.

According to an empirical study conducted by Porter (1993), 34% of the expectation gap is attributable to unreasonable public expectations, 50% to deficient standards, and 16% by auditors' sub-standard performance. It can be concluded that there are two ways to narrow the expectation gap: 1) lower public expectations and 2) improve the quality and relevance of audit. In cases of severe external shocks and a very wide expectation gap the response cannot be limited to the accounting profession. History has shown that even in countries with market-driven development of audit there is a need for policymakers and regulators to be included when deciding on a proper response.

The expectation gap is partly due to the unreasonable expectations of users of financial statements, who often suppose that auditor have the capabilities to give absolute assurance in "truth and fair" presentation of financial statements or even to detect every possible fraud. It seams that there is never a clear understanding of the nature of auditing and its inherent limitations. Attempts have been made to educate the public and to clarify what exactly the duties of an auditor are. In this regard, improving the wording of auditors' reports is considered important because they are the key output of an audit and the right place to communicate audit objectives and scope to all users of financial statements. This happened in the United States with the transition from the term "certify", which was usually used in the 1920s and implied some kind of guarantee by the auditor regarding financial statements, to the term "giving an opinion" in the 1930s (PCAOB, 2011). The form and content of the auditor's report continued to change not only in the United States but also in the rest of the world, which indicates that the expectation gap was always present. The International Accounting and Assurance Standards Board (IAASB) modified the International Standard on Auditing (ISA) 700 several times regarding the auditor's report. Gold, Gronewold, and Pott (2012) examined if changes in the ISA 700 that became effective in 2006 (the most important of which were the inclusion of an explanation of auditor versus management responsibilities and a short description of audit work in the auditor's report) reduced the expectation gap. Interestingly, positive effects were not proven. This is just one illustration that lowering public expectations is not an easy task. Nevertheless, every activity to improve investors' understanding of the extent of assurance provided by auditors should be encouraged.

The auditing profession must also enhance the quality and relevance of the audit to better cope with user expectations. Improvements of the audit have mostly concentrated on strengthening independence rules, introducing more effective auditing standards, establishing more comprehensive supervision, and a stronger sanctioning regime. But that does not seem to be enough.

Perhaps the key challenge for the future of audit is in the area of auditing objectives. In early audit practice the objective of detecting fraud was much emphasized. At the beginning of the 20th century Dicksee (1907, pp. 7-8) described the object of audit as detection of technical errors, errors of principle, and detection of fraud, the latter being "a most important portion of Auditor's duties" and "undoubtedly a branch that their clients most generally appreciate". But as companies got bigger it was no longer practical or possible for auditors to examine every transaction, and they started to apply new methods such as sampling and reliance on internal control. The primary focus of auditing changed from detection of fraud to detection of misstatement in financial statements, so the objective of auditing became verification of financial statements. Instead of searching for evidence of fraud, audit work on verification of financial statements implies examination of their conformity with generally accepted accounting principles. This was in line with the expansion of public corporations and the need to provide credible financial statements as a sound basis for public investors' investment decisions.

Nevertheless, the discussion about the auditor's role in the detection of fraud and failure is reinvigorated with each big corporate scandal, wave of corporate bankruptcy, or financial crisis. History is repeating itself in the latest financial crisis. More and more stakeholders believe that the audit was powerless in the role attributed to it. Exploring the "powerlessness" of auditing in the context of the new crisis, Sikka (2009) criticizes the existing auditing model and explains, "markets do not seem to have been assured by unqualified audit opinion". He points out that "how the auditors constructed audits to satisfy themselves that banks were a going concern are open to conjecture, but the financial difficulties of many became publicly evident soon after receiving unqualified opinion."

A literature review by the Maastricht Accounting, Auditing and Information Management Research Center (MARC, 2011) shows that users of financial statements would appreciate more information from the auditor regarding fraud, including not only further clarification of the auditor's responsibility but also an estimation of the likelihood of fraud and illegal acts. And even more, the survey indicates that the public wishes to see the auditor's assessment of the sustainability of a client's business. MARC's earlier research project (MARC, 2010), based on interviews with CFOs and audit committee members, illuminates the need for a new audit model that includes a holistic view of business instead of a compliance-driven approach. The Association of Chartered Certified Accountants (ACCA, 2011) expresses a belief "that the auditor is well placed to assess and report on the client's business model, or at least on the financial assumptions underlying that model" and supports the expansion of the role of audit: "such a development – which would focus on business risks rather than just the risks of material misstatement of the financial statements – would, in our view, help genuinely address the so-called 'expectations gap', rather than continuing the long-standing, and futile attempts to 'educate' the public into the limitations of audit".

In the following we discuss the latest steps taken by the profession and policymakers in order to narrow the recent expectation gap, which is unusually wide as consequence of the economic crisis. Some of them are not new, but some are. The European Commission (EC) took a firm position on reforming the legislative framework of statutory audit, and a new Directive on statutory audit (2014/56/EU) and Regulation on specific requirements regarding statutory audit of public-interest entities (PIE) (No. 537/2014) entered into force in June 2014. European auditors must comply with rigid independence rules, but there is also a radical change in reporting: a more informative report is required, especially for the PIE. Interestingly, the Directive makes it clear that the scope of audit shall not include assurances of the future viability of the audited client or on the quality of corporate governance. However, the required extended auditor reporting is also valuable for these purposes. For instance, in the case of a PIE, statutory auditors must include in their report "description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud; a summary of the auditor's response to those risks; and where relevant, key observations arising with respect to those risks" [Article 10(2)(*c*) of the Regulation].

The International Auditing and Assurance Standards Board (IAASB) recognizes the critical importance of improving auditing reporting. Many options have been considered, and finally in 2013 the IAASB issued an Exposure Draft (ED) regarding new and revised IASs. The ED promotes greater transparency in auditors' reports, notably as a result of including in the report section "key audit matters". The communication of key audit matters provides users of financial statements with insight into significant matters that previously were communicated only to those charged with governance, for example, significant difficulties that the auditor has faced in certain audit areas. This eliminates the simple form of a 'clean' (unqualified) report, which can be helpful to users in assessing the quality of the financial statements. It also prescribes extended reporting on going-concern issues. The IAASB concludes that these additional disclosures in the auditor's report should increase the attention paid by both management and auditor to key audit matters and going-concern issues, and consequently should lead to the improvement of both financial reporting and audit quality (IAASB, 2013).

4.2. Lessons for Serbia

In the past two decades the globalization of economic flows and harmonization of financial reporting reduced some of the problems of the Serbian accounting profession and regulators, because it became evident that the need for development of national accounting and auditing standards is already a thing of the distant past. The acceptance of international standards eased the heavy load on a profession that was already in a bad condition. This also makes it easier to cope with the expectation gap, since regulators and practitioners can say that bad auditing also happens in the rest of the world. It could be said that domestic audit practice will close the part of the expectation gap that stems from deficient standards along with other countries that have adopted international auditing standards. However, Serbia has other specific expectation gap elements that must be narrowed.

Germany's experience in the period after WWI indicates that a trigger point is often necessary for accounting reform. As Harston (1993) concluded, in Germany economic crisis, not the activities of the infant accounting profession, was the trigger that resulted in legislative action mandating audit. Strengthening the role of the audit was stimulated by the desire to prevent further company failures. The ongoing economic crisis, whose consequences Serbia has been facing for a long time, resulted in, among other things, many company failures and presents a similar opportunity to take measures to strengthen the role of audit. The experience of Germany in the period between the two world wars shows that the promotion of audit and prescribing mandatory audit were necessary for the cooperation of the profession, the academic community, and the state. Only this cooperation created a strong enough counterbalance to the alliance of banks and corporations. The conclusion is that the Serbian government must help to promote the accounting profession and the academic community in the field of accounting and auditing. When market forces are weak it cannot be expected that the audit market will develop due to market-based incentives.

After several bad legislative solutions and a clumsy transition to reporting according to International Financial Reporting Standards (IFRS), the Serbian accounting profession is still divided into accountants and auditors. In fact, due to many years of bad treatment, it is questionable whether the accounting part of it can still be called a profession. To enhance the impression of separation, two separate laws have recently regulated the practice. The early experience of the UK discussed above and the experience of France in the period around WWI clearly indicate that audit cannot be successfully carried out without a strong accounting background, and the subsequent successful development of audit in Britain can to a large extent be attributed to the juncture of accounting and auditing. In addition, in Serbia part of the accounting profession has collapsed, since bookkeeping and preparation of financial statements do not have to be carried out by professional accountants. Poor accounting practice in companies presents an ideal terrain for the development of bookkeeping audit, which calls into question the auditor's independence. To our knowledge, auditors in Serbia are, at the very least, frequently involved in preparing notes to financial statements, while there are also cases where the auditor help the company to close the books. All these matters result in low public confidence in financial reporting and audit reports; i.e., indicate a wide expectation gap.

The lessons that should be taken into account in trying to narrow the expectation gap in Serbia are that:

- The profession should be united. It is necessary to abolish the separate profession of auditors and to return the title of "professional accountant", with the appropriate classification of subtitles, which would be acquired on the basis of education and qualifications.
- Development of audit requires qualified accountants in companies. Accounting education at universities and within professional associations should be encouraged.
- The reputation of the accounting part of the profession should be restored. Bookkeeping and preparation of financial statements should only be done by a professional accountant, who either provides services (private or public practice) or is employed in the company.
- In the absence of a sufficiently strong market mechanism, the government should be more proactive. The government should pay more respect to and promote the association of professional accountants. This would prevent a flood of unqualified 'experts' providing services.

- The scope of mandatory audit should be reviewed. Mandatory audit should be kept for the large companies, banks, and publicly listed companies. In order to prevent wastage of scarce resources, mandatory audits for medium-sized enterprises should be seriously reconsidered. Who benefits from the pro forma audit? Who benefits from audits that decrease public confidence and make the performance gap wider? In our opinion, medium companies should themselves decide if their financial statements should be audited, bearing in mind their specific needs and the cost and benefits of auditing.

5. CONCLUSION

Auditing is constantly evolving. At the beginning of the 20th century and during the period around WWI auditing was poorly developed. However, changes in audit at that time in response to critical events can serve as a guideline for making recommendations for the development of audits in the future.

After serious problems associated with major corporate scandals severely injured the reputation of the auditing profession just over ten years ago, the auditing profession is today again under scrutiny. The ongoing economic crisis has enlarged the expectation gap and, for the umpteenth time, auditors face new challenges.

The profession must recognize, well in advance, the changes in the demands of financial statements users and the general public. Much of these changes are caused by a variety of events in the environment, which often were major corporate frauds waves, the waves of companies' failures and economic crisis. Although it might not be possible to fully eliminate the expectation gap, by not learning from past mistakes the auditors themselves are largely responsible for its growth.

REFERENCES

ACCA (2011), Audit under fire: a review of the post-financial crisis inquiries.

Arthur Andersen and Co. (1974), *The first sixty years: 1913-1973*, Arthur Andersen.

Chandler R., et al. (1993), "Changing Perceptions of the Role of the Company Auditor, 1840-1940", *Accounting and Business Research*, 23 (92), pp. 443-459.

Day R. (2000), UK Accounting Regulation: An Historical Perspective, School of Finance & Law Working Paper Series.

De Paula, F.R.M. (1922), *The principles of auditing: a practical manual for students and practitioners*, second edition, Pitman, London.

Dicksee L. R. (1907), *Auditing – A Practical Manual for Auditors*, seventh edition, GEE & Co.

Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014, Official Journal of the European Union of 27 May 2014.

Edwards, J., Nibler, M. (2000), "Corporate Governance in Germany: the Role of Banks and Ownership Concentration", *Economic Policy*, October.

Evans L. (2003), "Auditing and Audit Firms in Germany Before 1931", *Accounting Historians Journal*, 30(2), pp. 29-65.

Gallhofer S., Haslam J. (1991), "The Aura of Accounting in the Context of a Crisis: Germany and the First World War", *Accounting, Organizations and Society, 16 (5/6)*, pp. 487-520.

Glynn, J. J. (1984). "The development of British Railway accounting: 1800-1911", *Accounting Historians Journal*, 11 (1), pp. 103-118.

Gold A., Gronewold U. and Pott C. (2012), "The ISA 700 Auditor's Report and the Audit Expectation Gap – Do Explanations Matter?" *International Journal of Auditing*, 16, pp. 286–307.

Harston, M.E (1993), "The German Accounting Profession — 1931 and Before: A Reflection of National Ideologies", *Accounting Historians Journal*, 20(2), pp. 139-162.

Higson A., (2003), *Corporate Financial Reporting: Theory and Practice*, Sage Publications.

IAASB (2013), Reporting on Audit Financial Statements: Proposed New and Revised International Standards on Auditing (IASs).

La Porta, R. et al. (1998), "Corporate Ownership around the world", *Journal of Finance*, October.

MARC (2011), A Framework for Extended Audit Reporting - Final Report, Research project commissioned by ACCA.

MARC (2010), The Value of Audit, Research project commissioned by the Standards Working Group/Global Public Policy Committee.

Markus H. (1997), *The History of the German Public Accounting Profession*, New York: Garland Publishing.

Matthews, D. (2006), "From ticking to clicking: changes in auditing techniques in Britain from the 19th century to the present", *Accounting Historians Journal*, 33(2), pp. 63-102.

Matthews, D. (2013), *A History of Auditing: The Changing Audit Process in Britain from the nineteenth century to the present day*, Routledge.

Öhman P., Wallerstedt E. (2012), "Audit regulation and the development of the auditing profession: The case of Sweden", *Accounting History*, 17(2), pp. 241-257.

Porter, B. (1993) "An empirical study of the audit expectation-performance gap", *Accounting and Business Research*, 24.93, pp. 49-68.

PCAOB (2011), Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards.

Quick R. (1990), "Die Entstehungsgeschichte der Aktienrechtlichen Pflichtprüfung in Deutschland", *Zeitschrift für Unternehmensgeschichte*, Nr. 1., pp. 217-236.

Ramirez, C. (2007), "Exporting professional models: the expansion of the multinational audit firm and the transformation of the French accountancy profession since 1970", Les Cahiers de Recherche - Groupe HEC, working paper.

Robb, G. (1992), *White-collar crime in modern England: Financial fraud and business morality 1845–1929,* Cambridge: Cambridge University Press.

Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC, Official Journal of the European Union of 27 May 2014.

Roberts, T, Cannon. J. (1987), "The American Association of Public Accountants (1908)", *The Accounting Historians Journal*, 14 (2), pp. 99-108.

Sikka P. (2009), "Financial crisis and the silence of the auditors", *Accounting, Organizations and Society*, 34 (6/7), pp. 868-873.

Wooton C., Wolk C. (1992), "The Development of 'The Big Eight' Accounting Firms in the United States, 1900 to 1990", The Accounting Historian Journal, 19 (1), pp. 1-27.

Zeff S. (2003), "How the U.S. Accounting Profession Got Where It Is Today: Part I", *Accounting Horizons*, 17 (3), pp. 189-205.

Chapter 18

Institutional Work Blending Commercial and Social Entrepreneurship: Djordje Weifert and the Formation of Banking Associations during Early Serbian Industrialization

Dragan Lončar*
E-mail: loncar@ekof.bg.ac.rs

Dragan Budić**
E-mail: draganbudic@gmail.com

Abstract: The purpose of this paper is to examine the role of Djordje (George) Weifert's entrepreneurial institutional work in the formation of the first Serbian cooperative financial institution during the early years of Serbian national industrialization. We also examine institutional work for the maintenance of this institution during the time period before and after World War I (WWI). Examining the long-term resilience of this institution is relevant because it was not formed top-down by the government, as was the first Serbian Central Bank, but rather collectively by individual socially conscious entrepreneurs. These commercial entrepreneurs collaborated as social entrepreneurs by exhibiting stewardship behaviors in their commitment to create a financial cooperative as an institution that would serve the common good in Serbia. Going beyond their individual interests as commercial entrepreneurs, this group of entrepreneurs,led by Djordje Weifert, a pioneer in the Serbian brewing industry, formed the first Serbian financial cooperative aimed at preventing the growth of loan-sharking,which was spreading during the early years of Serbian independence and stifling the potential for long-term growth of the Serbian economy. To explain the process of this institution's formation and maintenance during pre- and post-WWI years, we have integrated stewardship and institutional work theories and developed a model for an empirical test using an archival method of data collection. We employ an in-depth narrative analysis of both secondary (books) and primary (archival) data relating to Weifert's institutional work, with the objective of explaining why and how commercial entrepreneurs like Weifert acted as social entrepreneurs committed to providing long-term societal benefits for the Serbian economy. Following the presentation of our analysis, we discuss our findings and highlight the significance of this study.

Key Words: Institutional Work, Entrepreneurship, Financial Cooperative, Stewardship

---

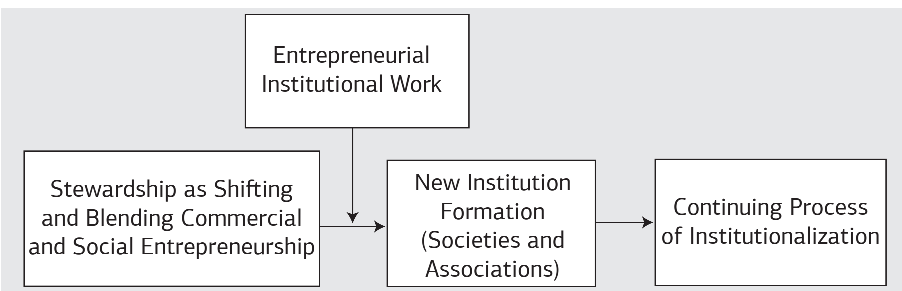
* Faculty of Economics, University of Belgrade. This paper is a part of the project (№ 179050) funded by the Ministry of Education, Science and Technological Development of the Republic of Serbia
** Texas A&M - Commerce University MBA alumnus

I. INTRODUCTION

The two types of entrepreneurship, social and commercial (Hayek, 2012), are often combined to produce both economic change and social change (Alvord, Brown, and Letts, 2004). Combining these two types of entrepreneurship can be a unique way of initiating the creation of new institutions when a country is in the early phase of industrialization (Hayek & Salem, 2011; Humphreys, Pane-Haden, Hayek, Einstein, Fertig, Paczkowski, & Weir, 2012; Voronov& Vince, 2012; Hayek & Harvey, 2012) and there is a societal need to replace the extant informal institutions with formal institutions (Dimaggio& Powell, 1983; Maguire, Hardy, & Lawrence, 2004; Battilana, Leca, and Boxembaum, 2009). We explain how Djordje Weifert combined commercial and social entrepreneurship as one of the first commercial Serbian entrepreneurs who also acted as a social entrepreneur and established the first Serbian industrial and banking societies and associations. Weifert and his allies created an entirely new institution an entirely new institution to bring both social and economic change to Serbia's growing economy during the time period after the country's independence in 1878.

In this paper we explain how Weifert combined commercial and social entrepreneurship at the beginning of Serbian national industrialization. This forming was important because during this period Serbian institutions were mostly weak and informal, and therefore actions of entrepreneurs could have been very important in formalizing and strengthening them. Therefore, it is important to research the factors influencing Weifert's success in acting as a steward to create new institutions through social entrepreneurship. Our proposed model containing the relevant factors is shown in Figure 1. It posits combining commercial and social entrepreneurship, requiring the entrepreneur to behave as a steward when forming the first business institutions and associations of a country during its early industrialization (Barley, and Tolbert, 1997). In order words, the entrepreneur combines commercial and social entrepreneurship resources to perform institutional work to form a new institution. For example, Weifert recognized an opportunity to form the first Serbian financial cooperative.

Figure 1: Theoretical Model of Entrepreneurial Creation of New Institutions



This paper is organized in the following way: Firstly, we present the theoretical foundations of the model shown in Figure 1, and secondly the case method used to examine Weifert's commercial and social entrepreneurial activities. Thirdly, a short biography of Djordje Weifert is provided focusing on his role as an institutional steward leading the process of forming early Serbian business institutions. Finally, we explain how the archival data describing Weifert's entrepreneurial actions support our proposed model.

Weifert's stewardship and institutional work performed in forming the first Serbian financial cooperative was critical for both the functioning of commercial entrepreneurial ventures and the growth of the early stages of industrial development. Cooperatives are unique institutions that are owned by their members, to maximise benefits rather than profit. During Weifert's time thousands of agricultural, consumer, and financial cooperatives were formed with members having equal voting rights in England, the United States, Germany, France, Italy, Russia, and Serbia. But the financial cooperative founded by Weifert was a unique institution in Serbia because it issued shares to its members, and as well lent members funds at reasonable interest rates (Taylor, 1971).

This paper provides several contributions to the literature on entrepreneurship and institutional work. First, we introduce the idea of entrepreneurial stewardship as a combination of commercial and social entrepreneurship, when the entrepreneur acts as a steward in the formation of a cooperative institution.

The second contribution of this paper is the analysis based on archival data of Weifert's behavior as a social entrepreneur performing institutional work in the formation of the institution. His actions stemmed from his recognition of the need to form a new institution.

The third contribution of this paper is a detailed analysis of the institutionalization process that evolved after Weifert had completed his entrepreneurial institutional work. When a certain amount of entrepreneurial institutional work is performed, asocial order is established in the functioning system of the cooperative and the institutionalization process can be instituted. Archival data shows that the Belgrade Cooperative continued to function successfully even after Weifert resigned from the leadership position, because the process of institutionalization was maintained.

This paper explains the important role of entrepreneurial institutional work in the process of forming an institution. When Weifert saw an opportunity to change the dysfunctional predatory practices of loan sharks and establish a formal institution of cooperative lending in Serbia during its early industrialization the practices and processes of lending and borrowing money slowly but surely became institutionalized.

II. THEORETICAL FOUNDATIONS AND HYPOTHESIS DEVELOPMENT

1. Conceptualizing the Entrepreneur as an Institutional Steward

Conceptualizing the entrepreneur as an institutional steward means theorizing how commercial and social entrepreneurship are combined to create wealth in the community through the creation of a new cooperative institution. The notion of entrepreneurial stewardship implies that entrepreneurs behave collectively in a caring and respectful manner toward each other and toward the assets of the cooperative institution and of its external stakeholder community (Lane and Watson, 2012). When a cooperative institution is forming, stewards exhibit concern and care for the assets that belong to the members because use of the members' assets comes with the responsibility to use them for the members' best interests. This responsibility for members to look after other members' assets is very important for the institution's long-term survival (Taft, Bogle and Ellis, 2012). For a cooperative to survive, entrepreneurial stewards must create a culture in the institution where the members clearly act equally in their use of the institution's assets**.** Institutional members' concern for the well being of the institution reflects their commitment to fellow members,thus making all feel responsible for the quality of their relationship (Waters, 2011).

Entrepreneurial stewardship signifies the process of creating equal relationships between the institution's members (Karns, 2011), and requires that, as a steward,the entrepreneur together with other members of the cooperative be involved in and devoted as stewards for to the cooperative institution's assets (Kulkarni & Ramamoorthy, 2011), showing a "protective restraint, a taking care of resources through nurturing and thrifty management of their use" (Leopold, 1998: 228). For the institution to be formed, entrepreneurs, as stewards, need to be strongly committed to the institution's purpose. The founders of the cooperative use institutional resources to sustain the institution's continuity (Magill & Prybil, 2004; Pirie & McCuddy, 2007). A devoted steward that is co-managing anew cooperative institution should respond to all assigned duties given to him with honesty and responsibility. S/he always needs to bear in mind the long-term benefits of the institution (Lewis, 2005). In addition, stewardship implies responsibility toward the community (Wade-Benzoni, Henrandex, Medvee and Messick, 2008).

Stewardship stems from the entrepreneur having an equal share in the ownership of the cooperative institution and from his/her social role in the community of its stakeholders (Spears, 2003; Hernandez, 2012). Therefore, an entrepreneurial steward is committed to protecting the institution's assets and the members' welfare (Purkey & Siegel, 2002) by caring about the reputational aspects of the institution (Greenleaf, 1970/1991). This caring, which is focused on others, "requires us to think about the leader-as-steward in terms of relationships: of assets and legacy, of momentum and effectiveness, of civility and values" (De Pree, 1989: 13). A good entrepreneur, behaving and leading as a steward, knows how to balance his/her willingness and eagerness to forman institution with his/her patience when solving the problems that come along when maintaining its continuity (Senge, 1990). This balance is very important because entrepreneurs who are stewards are not only there to initiate the institution's formation by combining commercial and social entrepreneurship, but also to secure the continuity of its future operations (Caldwell, C., et al., 2008). Hence, we hypothesize as follows:

HYPOTHESIS 1: During the early phase of national industrialization, the entrepreneur's stewardship, combining commercial and social entrepreneurship, will lead to the formation of a new institution such as a cooperative association.

2. The Entrepreneur Performing Institutional Work as a Steward

The power of a commercial entrepreneur who, is behaving as a social entrepreneur, is initiating the formation of a new cooperative institution in the common interest, comes from his/her salient position in society: when recognized commercial entrepreneurs behave as social entrepreneurs they can use their influence and power to initiate the formation of new institutions (Maguire, 2007). Studies of institutional work indicate that the main way in which commercial entrepreneurs can effectively involve themselves is to become stewards. As stewards, they typically create allies with other influential members and friends in the community, particularly those who have the same institutional expectations (Bruton, Ahlstrom, and Li, 2010; Dacin, Dacin, and Matear, 2010). The entrepreneur needs to have the power to ensure that other important individuals in their communities fully accept the new institutional norms (Sharir, and Lerner, 2006). To be successful in influencing the acceptance of cooperative norms, they must be recognized as commercial and social entrepreneurs of public prominence and personal ability (Mair, and Marti, 2009; Leca, and Naccache, 2006). The case of Djordje Weifert is an example of how stewardship combining commercial and social entrepreneurship brought necessary changes to the economy and social change to Serbia in the early days of its independence and industrialization. Weifert, as a steward, was devoted to modernizing Serbian institutions, with the goal of improving the social and economic life of Serbian citizens.

However, we still do not know what part Weifert's institutional work played in the relationship between his stewardship and the successful formation of a new cooperative. We argue that Weifert's entrepreneurial actions added new institutional capacity that was critical for the growth of the Serbian economy during its early industrialization, and changed the attitudes of the Serbian business community.

The archival data indicate that the first new institutions, such as industrial associations and financial cooperatives, were created in Serbia through the institutional work of entrepreneurs like Weifert, who were committed to combining commercial and social entrepreneurship (Tracey, Phillips and Jarvis, 2011). A detailed study of Djordje Weifert's institutional work creating the first business associations and societies in the newly independent Serbia at the beginning of the 20th century is necessary to assess its impact. We argue that his work as an institutional steward was the key factor in the creation of the new institutions (Garud, Hardy, and Maguire, 2007; Wiklund, Davidsson, Audretsch, and Karlsson, 2011). Hence, we hypothesize as follows:

HYPOTHESIS 2: The effectiveness of entrepreneurial stewardship in the formation of a new institution will depend on the entrepreneur's institutional work.

3. Institutionalization of Post-Entrepreneurial Institutional Work

Some entrepreneurs do not only engage in commercial entrepreneurship but also want to serve as stewards and "feel accountable to some larger body than themselves" by forming cooperative institutions of public interest that are committed to their members and bonded in a culture that promotes cooperation (Block, 1993:6). These entrepreneurs, behaving as institutional stewards, are devoted to "the values and ideas that help shape the organization as a covenantal community" of both the cooperative institution's internal members and its external stakeholders (Sergiovanni, 1992: 125). Although they are self-interested, they do not want to abuse the power of their salient position in the community. The cooperative culture that encourages stewardship is "particularly important when decentralization aims to enhance responsiveness to constituents" (Segal, 2012:833).

During the early industrialization of a nation the most important yet latent activities are performed by entrepreneurs embedded within their communities and capable of building new institutions of common interest. This institutional work that evolves into a process of forming a new institution requires entrepreneurial stewards to serve the common interest of a cooperative institution in which they have equal ownership. They typically create a cooperative culture that influences the institution's members to behave as institutional stewards that make selfless decisions (Sieger, Zellweger & Aquino, 2013). This sense of stewardship in performing institutional work links the entrepreneur who is the founder of the cooperative to other internal and external stakeholders of the cooperative institution. The more the entrepreneur acts as a steward, the more likely it is that the stakeholders will behave in a similar manner. The members of the cooperative will not be selfish if the entrepreneurial steward acts selflessly and does not abuse the power of his dominant position in the cooperative and in the community. Institutional stewards act this way because they are equal owners of the cooperative institution, and therefore interact cooperatively with all stakeholders with the objective of securing the institution's long-term relationships in the community (Hernandez, 2008).

An entrepreneur who creates a psychological culture of stewardship influences other institutional members so that they feel themselves to be "psychological principals" (Pierce, et al., 2003: 101). Members of the cooperative institution will behave as psychological principals or institutional stewards when they perceive that the institution is formed as an"extended self" (Belk, 1988). Then they will be motivated to cooperate with other institutional members and will develop a strong sense of shared identity and equality (Liu, Wang, Hui & Lee, 2012). This means that an entrepreneurial steward will positively influence other institutional members to mirror his or her selflessness for the benefit of the cooperative institution and the wider community.

By servicing and acting as a steward, an entrepreneur identifies with the other institutional members as a social and institutional entrepreneur who is the "first among equals" (Greenleaf, 1976, p. 16). Social entrepreneurs who behave as institutional stewards tend to plan and act with long-term goals in mind because they feel accountable to save and augment the available resources of the new cooperative institution in order to secure its continuity and a stable future (Taft et al, 2012). These entrepreneurs have a committed willingness to work toward a joint goal, serving as stewards with other institutional members (Zahra, Hayton, Neubaum, Dibrell, and Craig, 2008; Miller, Le Breton-Miller, and Scholnick, 2008) so that the process of institutionalization will continue to develop. Hence, we hypothesize as follows:

HYPOTHESIS 3: Over time, the formation of a new institution will evolve into a continuing process of institutionalization through continued entrepreneurial stewardship.

III. METHODOLOGY

We used case research method in this study by focusing on a historical case (Yin, 1993). The method of using a case design focused on archival data is appropriate because the context of the study is unique. The use of a historical case design provides an appropriate framework to analyse the effectiveness of Weifert's institutional work during early Serbian industrialization.

A historical framework is very helpful when using case studies to test theory, especially when the case design is used to "provide inter-temporal comparisons that can reveal how continuities and discontinuities in mechanisms and contexts affect outcomes predicted by theory" (Tsang, 2012: 5). As this design may reveal patterns of empirical regularities, it is appropriate for a study of relations between entrepreneurial institutional work and the process of institutionalization. Our emphasis in using this historical case design is on “the priority of explanation over prediction in theory testing” (Miller and Tsnag, 2010:145).

The main goal of our analysis of a case study through a historical lens is to find the mechanisms that might explain the role of entrepreneurial institutional work in the process of forming a cooperative institution. We analyse this role, hypothesized in our proposed model, by reviewing archival data on Weifert’s entrepreneurial stewardship. This analysis is based on a narrative analysis of primary and secondary data about Weifert’s entrepreneurial institutional work (Reed, 2012).

Through narrative analysis and qualitative comparisons, we examine the relationship between observable actions and their consequences hypothesized in the model. Our search for explanations is guided by the findings of our narrative analysis,which indicate whether the proposed model fits the collected archival data. In other words, our narrative analysis and qualitative comparative analysis of change in Weifert’s entrepreneurial institutional work is conducted to understand the process of its influence.

Our goal is to examine the impact of Weifert’s institutional work proposed in the model. Following the suggestion of Tsoukas (1989), the model of entrepreneurial institutional work is examined by using a detailed narrative analysis of the Weifert case with the objective of uncovering the mechanisms of his institutional work. The Weifert case is appropriate for the model examination because it describes how the practice of lending money at exorbitant rates(loan sharking) during early Serbian industrialization was terminated by Weifert’s entrepreneurial institutional work, his stewardship, and the formation of the first Serbian lending cooperative.

To capture this process using the historical case-based method, we conducted a narrative analysis of data from secondary sources and from the primary sources of the archives of Serbia, the City of Belgrade, and the National Bank of Serbia.

IV. DATA ANALYSIS AND FINDINGS

1. Secondary Data

a. Narrative Analysis of Weifert’s Institutional Work of Blending Commercial and Social Entrepreneurship

Djordje Weifert (1850-1037) was one of the most significant commercial and social entrepreneurs during the early stage of Serbian industrialization and institutionalization. He was born in Pancevo (roughly ten miles north of the Serbian capital of Belgrade) in today’s Serbia, but at that time part of Germany. Djordje’s birthplace was populated by a mix of German, Hungarian, and Serbian merchants and artisans. His parents worked mostly in crafts, and his father acquired a brewery business through marriage. Djordje was sent to be educated in Budapest and Bavaria so that he could inherit and take over the brewery business. He was advised to become a Serbian citizen so that he could secure the right of property ownership, which he did in 1873, five years before Serbia became an independent country (Millekar, 1925/2009).

In the early years of Serbian independence the brewery business was one of the main drivers of the country's industrial growth. To capitalize on this trend, at the end of the 19th century Djordje Weifert built the largest and most up-to-date brewery in Belgrade. Weifert made his Belgrade plant the strategic centre of the network of his other plants and warehouses located across Serbia. With the establishment of this network the Serbian brewing industry became a duopoly dominated by Weifert and his main rival,Bajloni. To insure that this rivalry was productive rather than destructive, in 1913 Weifert co-opted Bajloni to jointly form the first Serbian shareholder association of beer, molasses, and ice producers, thus exhibiting stewardship, and performing institutional work as a social entrepreneur (Ilic, Jerkovic, and Bulajic, 2011).

When post-World War I Serbia became part of the Kingdom of Serbs, Croats, and Slovenes, Weifert faced a new rival in the expanded market: Union, the leading Slovenian brewery. The Weifert Brewery competed successfully in the new expanded Yugoslavia through the 1920s and experienced significant growth, which continued until 1930 when the worldwide economic crisis hit the country. During the 1920s Weifert increased his brewery capacity to 2.5 million litres, built his own power plant, created and integrated a wider network of molasses and ice operations, and nearly doubled the number of employees. However, after 1930Weifert's brewery business was heavily hit by the global economic crisis, competition from Central Europe, and the lingering conflict with Belgrade's independent distributors. As a result of these stressful circumstances his health suffered, and Weifert died in 1937 (Ilic, Jerkovic, and Bulajic, 2011).

Weifert's stewardship and institutional work while acting as a commercial and social entrepreneur was not limited to the brewery business but extended to the mining and banking sectors as well as philanthropy. In 1881 Weifert purchased the rights to mine coal in Kostolac, a town near Belgrade, where his main steam brewery needed a reliable power supply. Weifert complemented these commercial entrepreneurship initiatives with social entrepreneurship by becoming one of the founders of the Serbian Mining Society, whose formation he initiated in Smederevo in 1913.By 1921 he had erected a wagon factory, a steelyard, and a shipyard (Ilic, Jerkovic, and Bulajic, 2011).

Weifert's most important institutional work was in the banking sector. Here, his main goal as a social entrepreneur was to halt the boom in the informal loans harking businesses,which was detrimental to Serbian industrial development. In 1882 he initiated the formation of the first Serbian credit association, the Belgrade Cooperative for Mutual Assistance and Savings. Weifert was Chairman until 1890 when he was appointed Governor of the Serbian Central Bank and was no longer allowed to serve. However, he continued to support the cooperative indirectly;for example, by insuring his brewery with the cooperative. Weifert retired from the position as Governor of the Serbian Central Bank in 1926 (Ilic, Jerkovic, and Bulajic, 2011).

Weifert was not only a commercial and social entrepreneur but also one of the most outstanding Serbian philanthropists. He co-financed the establishment of several churches and hospitals, and made significant donations to charities for children with speech and hearing problems and handicapped war veterans. Weifert was also a passionate antiques collector, and eventually donated his collection of valuable old coins to the National Museum of Belgrade.

b. Narrative Analysis of Weifert's Stewardship and Institutional Work: Weifert as Visionary and Enthusiast

During the entire 19th century the young Serbian state was fighting a battle on several fronts. Along with the battle for political independence, which was finally won at the Congress of Berlin in 1878, it was necessary to invest in the development of institutions and in the industrial plants that were critical for economic growth (Ilic, Jerkovic, and Bulajic, 2011).

For commercial activity to grow and industry to develop, Serbian middle class consumers and entrepreneurs needed access to capital. It was the absence of access to money and capital in Serbia that led to loan sharks, who charged interest on loans of between 25% and50%. To prevent these dysfunctional business practices spreading further, Weifert decided to act as a steward and create alliances with other Serbian entrepreneurs, with the objective of forming an association for cooperative mutual aid, the seed money for which would be provided by small weekly deposits(Ilic, Jerkovic, and Bulajic, 2011).

Due to Weifert's institutional work, the Belgrade Cooperative for Mutual Aid and Savings was officially formed on October 1, 1882. The objective of the Cooperative was to provide credit to entrepreneurs involved in production, commerce, and artisanal work. Its by-laws decreed that it should accept money not only for savings and checking accounts but also for cashier's checks, and issue loans on warrant, cheques, and rent coupons, and mortgage policies and receipts (Ilic, Jerkovic, and Bulajic, 2011).

Weifert served as the Chairman of the management board of the cooperative until 1890 when by royal decree he was appointed Governor of the Serbian National Bank. As based on Article 35 of the Statue of the National Bank he was prohibited while serving as the Governor to be a board member of any other financial institution, he resigned from the position of Cooperative chairman. Because of his exceptional track record of stewardship,which had been crucial to the cooperative's development and success, the other board members elected him Honorary Chairman of the management board. The cooperative's assembly accepted this vote in 1890 (Ilic, Jerkovic, and Bulajic, 2011). Weifert continued to provide advisory services relating to the development of the cooperative, particularly the formation of its Insurance Department in 1897. As a sign of his committed stewardship and his belief in the quality of this institution, he insured his own brewery with The Belgrade Cooperative.

During his early days as chairman of the cooperative, Weifert shared the opinion of business circles in Serbia favouring the establishment of a central bank. However, these business circles were split on the issue of whether this bank should be formed with domestic or foreign capital. Weifert's successful experience raising capital for the Belgrade Cooperative showed that it was possible for Serbia to establish a national bank with domestic capital (Ilic, Jerkovic, and Bulajic, 2011). A conference of businessmen (the 'May Conference') was called for May 20, 1883 in order to get a consensus on this issue, where it was agreed that the National Bank would be founded with domestic capital.

The capital raised and registered, and the first Management Board was elected at the shareholder assembly held on Feb 26-29 1884. Weifert became a member of this board based on the number of shares he had purchased. Aleksa Spasic was appointed Governor of the National Bank by royal decree on March 8 1844, while Weifert, as a member of the Management Board, was assigned Vice Governor, based on his extensive business ties and experience in commercial activities,which were expected to help the National Bank establish its reputation in the Serbian business community. Weifert served as Vice Governor until 1890, when on March 7, by decree of King Aleksandar Obrenovic, he was appointed Governor of the Privileged National Bank of the Kingdom of Serbia (Ilic, Jerkovic, and Bulajic, 2011).

Weifert served as governor until his retirement in August 21, 1926. However, his ties with the National Bank did not end with his retirement. In the bank's report for 1926 it states, "The Management Board, respecting the service of G.W., the only living founder of the National Bank, who served as the Vice Governor for 6 years, the Governor for 26 years and 9 months, and a member of the Management Board since the bank came into existence, appoints him as the honorary Governor of the National Bank for life" (Ilic, Jerkovic, and Bulajic, 2011).

c. Summary of Findings Derived from the Narrative Analysis of Secondary Data

Weifert performed institutional work in the banking sector and initiated the formation of the first Serbian lending cooperative by combining commercial and social entrepreneurship, serving as a steward committed to preventing the spread of the informal loan-sharking business,which was detrimental to the early development of Serbian industry. This provides support for Hypothesis 1.

2. Primary Data

a. Narrative Analysis of Weifert's Institutional Work Based on Archival Sources: 1) Archive of the National Bank of Serbia: The 25th Anniversary of the Belgrade Cooperative 1882–1907; 2) Archive of Yugoslavia: Annual Reports – By Year from 1891 to 1944

i. Economic Situation in Serbia During Early Stages of Industrialization when Belgrade Cooperative for Mutual Aid and Savings was Formed

The unfavorable economic situation during the early independence and industrialization of Serbia primarily hit the middle and working classes that lacked funds to set up small businesses. Lack of money resulted in loan sharks in Belgrade that charged 25% to 50% interest (Belgrade Cooperative [BC], 1910, p. 3). Their customers were mostly middle-class people that could not obtain loans from official institutions or other sources (BC, 1910, p. 4). The government and its institutions searched for a way to provide the means for the middle class to create businesses and secure incomes on along-term basis (BC, 1910, p. 1).

While the Serbian government had difficulty finding a top-down solution, Serbian businessmen started a bottom-up process of forming a cooperative association. "The Cooperative began its operation during the time when credit lending and borrowing in the country was formally very narrowly defined and thus very limited, and the idea of savings, especially small savings, virtually did not exist. There was limited understanding and practice of saving money in the wealthy elite circles, and even less in the circles with less money (BC, 1910, p. 52). Patriotic people who were aware of employees and workers' difficult economic situation decided that Belgrade should form a Cooperative for Mutual Aid and Savings,an association for the people of Serbia, particularly the working class, who would help each other through their modest savings (BC, 1910, p. 1). Svetozar Ristic and Kornel Jovanovic conceived the idea of establishing a banking institution. They needed to find at least one person who was well known, recognized in business circles, and whom people trusted, as they faced failure if they were to approach this business venture on their own. Ristic approached Tasa Bankovic, a person well respected in Serbian society (BC, 1910, p. 4). Bankovic asked Franja Vsetchi and Djordje Weifert to join the cooperative formation board (BC, 1910, p. 5). Using an association model from other countries, they focused on providing assistance to lower and middle class people who had small amounts of money to invest, so that a craftsman, merchant, a clerk, or any other worker could get financial help when needed (BC, 1910, p. 6).

ii. The Formation of the Cooperative and Initial Years, 1882-1900

In 1882 the Managing Board of the Belgrade Cooperative unanimously chose Djordje Weifert as President. From the day of his election until 1890, Weifert continuously served as Chairman of the Cooperative. He was a committed steward from its formation because he believed that the Belgrade Cooperative was essential for the growth of the Serbian economy and wanted to ensure its successful and stable foundation and its continuous future development.

Weifert performed tireless institutional work laying a stable foundation for the Cooperative, often going outside the scope of his duties as Chairman and as a member of the managing board (BC, 1910, p.40). When the Association had its first crisis in 1882, when a financial instrument was submitted for 120 ducats and the Cooperative did not have sufficient funds to cover it, Weifert provided a significant portion of the funds that the Cooperative lacked, so that it could cover the entire amount and avoid disruption of operations. As a genuine steward, Weifert also made frequent donations to the Cooperative without asking for any reimbursement (BC, 1910, p.40).

Due to the Belgrade Cooperative's exceptionally low interest rate, the incoming rush of shareholders was so big on the first several days that the managing board extended the opening hours until all shareholder cards had been issued (BC, 1910, p.40). During its initial phase the Cooperative could not generate a significant profit or dividends for its shareholders because it was not profit-driven, but the Cooperative succeeded in convincing people of the importance and benefit of saving and mutually beneficial behaviour(BC, 1910, p.53). During this time the Cooperative had three working departments, a business department, a banking department, and an insurance department (BC, 1920, p.10).

At the very beginning of the Belgrade Cooperative's operations it had only three paid employees. It took a full ten years for the managing board to be able to have any full-time employees with paid social security and secure life and work insurance (BC, 1910, p.34). Before then,and before the Cooperative was financially strong and stable, in order to save money each member of the managing board worked for the Cooperative as a clerk,managing daily transactions (BC, 1910, p. 40).

Managing Board members worked hard, conscientiously, and honourably without any compensation for five years, leading by example to encourage the middle class to get involved in mutual aid and making it possible to loan money at low interest rates. For an entire week at a time,Weifert, Vsetecki, and others, one after another, worked as Cooperative clerks, and they did it wholeheartedly. It was a truly unique example of devoted, unselfish work with no personal benefit (BC, 1910, p.40).

In the first half of 1887 the managing board took the first steps to organize the Cooperative efficiently. By this time the Cooperative's work was diverse and had increased significantly. During a meeting in 1887 the managing board decided to divide the Cooperative into five main departments beside wages: 1) Accounting Department, 2) Department for Repo Transactions, 3) Loan and Deposit Department,

4) Department for Payments and Deposits on Shareholding Cards, 5) Department for Bill of Exchange Management (BC, 1910, p.36).

The managing board thought that the Cooperative needed to organize its operations to stimulate the economy and industrialization through low-cost equity and a well-organized credit policy, so giving a stronger stimulus to money circulation (BC, 1910, p.55). Thus the Belgrade Cooperative's business direction contributed to the country's trade and socio-economic development. During its initial years of operation the Belgrade Cooperative helped many people who had been borrowing from loan sharks, and saved them from bankruptcy. By so doing it gained the trust and admiration of the Serbian people (BC, 1910, p.52). The Belgrade Cooperative was protected from the possibility of other banking associations attempting to jeopardize its operation by the gratitude and loyalty of the people of Serbia.

The Cooperative was established during a time of hardship and scarce resources, when the first steps were being taken in stimulating the economy and modernizing industry, and it fast gained recognition (BC, 1891, p.3). Following the success of the Belgrade Cooperative in establishing a strong, valuable institution with domestic capital, in 1883 the Serbian government proposed a Law on the National Bank of the Kingdom of Serbia (Ilic, Jerkovic, and Bulajic, 2011). Djordje Weifert was named Governor of the National Serbian Bank by Royal Decree in 1890. He then had to resign from the position of President of the Belgrade Cooperative as the statute of the National Serbian Bank stated that the Governor could not be a member of the managing board of any financial institution other than the National Serbian Bank. Weifert tendered his resignation in a memo to the managing board, praising and thanking the select group of people who had contributed to the "transformation of one small association with very small investments in the early years" to become the"powerful banking institution of the Belgrade Cooperative after less than twenty years of work" (BC, 1910, p.41). He also stated his intention to continue, with the utmost interest, to closely follow the operations of the Cooperative and to rejoice each time it made progress. In order for the Cooperative to maintain its highly regarded status,Weifert wish edit harmonious and agreeable work, and advised the Cooperative to stay true to the principles on which it was built (BC, 1910, p.41).

iii. After Weifert's Resignation from the Cooperative in 1890

In 1891, the first year of the Cooperative's operation without Djordje Weifert's direct leadership, there was higher demand for credit because of new taxes. The Cooperative's job was becoming bigger and more complex year on year, and in 1891 it proved its size and strength by providing temporary loans to the municipality of Belgrade with bills of exchange of up to a million dinars (BC, 1891, p.3). The Cooperative also achieved unexpected success,with the interest rate dropping to 6% on most loans. The reason behind lowering the interest rate was the Cooperative's principle that it did not want the Cooperative to exist for the sake and benefit of the shareholders, but rather for the benefit of the people (BC, 1891, p.30).

In 1891 the Cooperative sacrificed high profits to secure operations and offer the lowest possible interest rate to the people it serviced (BC, 1891, p.31). The managing board was particularly focused on ensuring that the reserve department of the Cooperative was as secure as possible and decided to put all suspicious payments in that particular year at the expense of net profit without requesting money from the reserve funds. By so doing profits in 1891 were significantly reduced (BC, 1891, p.31).

The economic crisis that began in 1894 grew and was strengthened by suspicion and lack of trust in 1895. Due to the economic situation in the country and government instability, credit could not be guaranteed (BC, 1895, p.9). Despite the critical situation the Cooperative successfully finished 1895 without any disasters (BC, 1895, p.10).

Three years later, 1898 was satisfactory in terms of business, despite the banking sector temporarily closing. The launch of the new line of silver coins by the Serbian National Bank prevented it from meeting trade and credit needs, closing the bank and other banking associations. The Cooperative,however, actually extended working hours and workload in its insurance sector (BC, 1898, p.11).

Two years later, in 1900, even though the year was not good for industrial/economic development, growth,and opportunities, the Cooperative's business was going strong,primarily due to the reliability and trustworthiness the Cooperative enjoyed. The Serbian people chose the Cooperative, as the sole Serbian insurance institution, over all the other foreign insurance institutions in the country (BC, 1900, p.12).

The year 1903 was difficult for banking institutions in the Royal Kingdom of Serbia because,as in1902, the Serbian financial market suffered a significant shortage of silver. Regardless of this, the Belgrade Cooperative managed to maintain the offered discount with zero interruptions for the entire year (BC, 1903, p.10).

In 1905 the Cooperative's work continued to grow, and anew building was completed (BC, 1905, p.10). The Banking Department achieved notable success in 1909 when the wheat harvest was good and the price of wheat on foreign markets was favourably high. The trade agreement with Austria-Hungary did not have a significant negative impact on the Serbian economy, and thus 1909 was a turning point in the emancipation from and diminishing dependency on exports to the Austro-Hungarian market. The Insurance Department exhibited continuous expansion (BC, 1909, p.11).

Due to the Cooperative's continuous and significant development increased equity was necessary, and was met without the need for additional payments by the shareholders since the managing board had set aside an amount each year for bettering current reserve funds (BC, 1909, p.12).

1910 was an important year for the Cooperative, as the managing board increased the equity from one million to two and a half million dinars. The increase was drawn solely from the Cooperative's reserves. The Cooperative's business showed a measurable and significant advance in all of its departments. The Banking Department achieved solid success in 1910, as the demand for money was strong and steady throughout the year (BC, 1910, p.9).

From the business point of view, 1911 was much more productive and profitable than 1910. The Kingdom of Serbia's stable economy provided a favourable ground for successful business ventures, and demand for money was high throughout the year. The Association's active accounts totalled 1,808,801.95 dinars at the end of 1910, and an astonishing 4,970,351.95 dinars at the end of 1911. Repo transactions also increased in 1911, while loan and deposit business decreased (BC, 1911, p. 9).

1913 was a war year,when industry and trade was paralysed. All transactions and dealings in the country came to a complete halt during the entire year(BC, 1913, p.9). Financial results for the year 1913 were derived from the previous year (BC, 1913, p.10).

The beginning of the war stopped all work in the Cooperative, and the Cooperative was forced to leave its offices and set up operations first in Krusevac, then in Marseille, where it stayed until the liberation of the Kingdom of Yugoslavia (BC, 1920, p.10).

In 1920, after a break of full seven years, the managing board of the Belgrade Cooperative prepared a strategy for renewing operations after the long closure caused by the war (BC, 1920, p.9). The war happened at the height of the Cooperative's rise and the economic situation was still not close to normal, and thus the restoration was slow (BC, 1920, p.10). The Cooperative organized new branches in Zagreb, Novi Sad, Sarajevo, and Ljubljana. In addition, representative offices were established in the larger counties and in smaller towns, so there was access to the Cooperative in every large town in the Kingdom of Yugoslavia (BC, 1920, p. 11).

The export trade was not satisfactory in 1921 (BC, 1921, p.5), because exporters had to give up 30% of total foreign currency received from export sales. This negatively affected production and resulted in dinar depreciation (BC, 1921, p.6). However, despite all the financial disruptions, the Cooperative bank focused on purchasing, selling, and exporting food and had a successful year. There were a large number of transactions in the banking department,particularly in foreign exchange: never before had the bank dealt with as much money as it did in 1921 (BC, 1921, p.7).

In 1922 the country was still devastated by the recent war and its finances were unstable because of the unpredictable value of money. The banking department grew moderately due to increased money demand. The Cooperative's income was reduced due to irregular and faulty regulation concerning leasing of real estate (BC, 1922, p.10).

The first signs of economic upswing after World War I came in 1923, when there was an increase in production and exports and the country's financial situation finally stabilized (BC, 1923, p.10). However, economic activity was negative, and there was an official crisis obtaining credit. During this long and difficult general economic crisis the Belgrade Cooperative actually did well, thanks to its conservative and cautious credit policies in regard to investors as well as loan applicants. Even during the toughest days of the crisis the Cooperative did not stop the discount rate offer. The private banks put the interest rate up to an astonishing 50%, while larger, more prominent institutions increased it to 16%-20% plus commission. The Belgrade Cooperative prided itself that it did not raise the interest rate in 1923 at all. 1923 was a favorable year.

Both 1925 and 1926 were encouraging for the Belgrade Cooperative, despite the fact that the economy had not yet fully recovered. In 1926 the Cooperative advised its shareholders about the status of its bill of exchange repo transactions, which had increased nearly 40% since 1925. This was a visible sign that the Cooperative helped economic development and growth in the country. The Cooperative lowered the interest rate to its borrowers several times in 1926.

b. Summary of Findings Derived From Narrative Analysis of Primary Archival Data

The effectiveness of Weifert's stewardship, which combined commercial and social entrepreneurship,in forming the first Serbian lending cooperative during Serbia's early industrial development, depended on the level of his performed institutional work in the banking sector. This provides support for Hypothesis 2.

c. Quantitative Analysis of Primary Archival Data

The purpose of the quantitative analysis of the primary archival data, which is presented and interpreted in this section, is to assess whether the formation of the Belgrade Cooperative for Mutual Aid and Savings led, over time, to continuity in the process of its institutionalization, thus testing Hypothesis 3 of the proposed model.

All of the primary data that are quantitatively analysed and interpreted in this section are from the archives of the Belgrade Cooperative that cover the years 1882-1944. The 22 years for which there are no records and which therefore have no annual reports are: 1892-1894, 1896-1897, 1899, 1901-1902, 1904, 1906-1908, 1912, 1914-1920, and 1924-1926. There are annual reports for all of the initial eight years when Djordje Weifert was part of the Cooperative. However, there is no official archived data for Profit and Gross Income for the majority of the years until 1906.

In the subsequent paragraphs of this section, we interpret the Table that we composed from the collected primary archival data.

Table 1

Table 1 depicts the balance sheet items by year of the Belgrade Cooperative for Mutual Aid and Savings. The first eight years of the Belgrade Cooperative's operation exhibit continuous growth in equity, deposits, repo transactions, loans, and turnover. The deposits increased from 140,694 dinars to 1,833,039 dinars in the eight years, an increase of 1,509%, and indication that the trust people had in the Belgrade Cooperative rose year after year. Loans increased less than deposits, and this trend continued after the initial years. During the first eight years,of all the balance sheet items,turnover increased the most, by 5,132%. Such a high turnover growth demonstrates the solid efficiency of the Belgrade Cooperative during its founding years.

Large increases in turnover in 1890, 1891, and 1892 show the solid and successful continuation of the Cooperative's operations as its work increased and became more complex year on year (BC, 1891, p.3). In 1890 the Cooperative for Mutual Aid and Savings changed its legal entity from a cooperative into a shareholder money fund (BC, 1910, p.24).

There were large increases in both turnover and equity in 1909 and 1910. As the Cooperative's work began to grow it raised its equity. 1910 was an important year because the Managing Board increased the equity from one million to two and a half million dinars (BC, 1910, p.9).

In 1920, after a break of seven years caused by the war, the Cooperative returned from France and re-opened in Serbia (BC, 1920, p.9). Between1920 and1921 there was a jump in equity and turnover as the Cooperative began to recover from the war. In 1921, despite numerous economic disruptions in the country, the Cooperative bank had a successful year with a jump in equity.

There is no data for 1924 and 1925, but there is a jump in equity and turnover between1923 and1926. Both 1925 and 1926 were encouraging for the Belgrade Cooperative, with an increase in both business and number of clients in 1926.

In 1926, bill of exchange repo transactions showed a significant increase of nearly 40% over those of 1925, which was a sign that the Cooperative was helping the growth of the country's economy (BC, 1926, p.9).

The last significant jump in the reviewed years was a leap in equity, deposits, and repo transactions between 1928 and 1929. The year 1928 was the tail of a crisis in almost all Serbian industries,when the economy offered limited opportunities (BC, 1928, p.9), but 1929 proved very successful for bills of exchange, with 70,111,596.95 dinars worth of repo transactions in 1929, compared with 43,242,231.65 dinars in 1928. The Belgrade Cooperative was very fortunate that the negative economic situation in 1929 did not have a significant effect on its operations (BC, 1929, p.4).

Up until 1921, turnover exhibits a slow and steady growth. The turnover trend line has a very similar trajectory to the deposits trend line, but turnover begins to grow steeply around 1921, after the Balkan Wars and World War 1, two decades before a similar steep growth in deposits.

Table 1: Balance Sheet Items

BALANCE SHEET ITEMS								
Year	Equity	Deposits	Repo Transactions	Loans	Current Account	Gross Income	Profit	Turnover
1882	107,611	140,694	244,136	9,630				956,543
1883	107,611	140,694	244,136	9,630				2,864,773
1884	221,197	321,176	427,867	58,561	12,519			4,516,243
1885	413,226	459,098	616,874	96,673	58,319			10,588,558
1886	596,707	982,086	1,317,105	202,777	316			12,158,336
1887	754,349	1,058,662	1,347,474	306,825	619			20,625,991
1888	685,676	1,293,241	1,514,000	313,603	66,505			22,049,546
1889	848,798	1,833,039	1,876,770	594,155				30,515,451
1890	977,502	2,263,704	1,933,236	1,027,213	428,352			50,046,850
1891	1,343,440	2,583,973	3,071,572	1,333,004	820,430	316,655	140,181	84,202,584
1892	1,293,024	2,369,733	2,893,212	1,261,581	1,081,270			144,297,960
1893	1,386,642	2,744,743	3,134,030	1,034,317	802,367			137,587,723
1894	1,201,707	2,605,964	2,181,901	1,063,253	867,865			123,947,370
1895	1,054,000	2,997,554	2,202,943	1,128,301	1,229,240	408,578	156,855	133,204,059
1896	1,054,000	2,715,207	1,925,915	1,490,250	868,282			146,901,980
1897	1,054,000	2,924,043	2,039,849	1,479,440	786,098			142,869,506
1898	1,054,000	3,160,526	2,136,918	1,170,724	940,208	444,454	142,070	198,714,125
1899	1,054,000	3,023,243	1,957,042	1,103,383	1,202,636			208,772,516
1900	1,054,000	3,067,381	1,680,643	1,732,741	1,240,363	433,629	147,227	219,278,398
1901	1,054,000	3,182,257	1,881,442	1,694,500	1,475,323			230,282,584
1902	1,054,000	2,367,573	1,551,066	1,367,791	1,724,168			230,746,501
1903	1,054,000	1,858,454	1,479,770	1,033,595	1,624,435	453,107	207,350	226,038,824
1904	1,000,000	2,137,216	1,735,895	863,234	1,629,474			228,516,312
1905	1,000,000	2,200,199	1,643,446	1,259,622	1,775,770	469,207	192,238	227,023,645
1906	1,000,000	2,308,134	1,440,020	1,294,506	1,369,970			200,478,937
1909	1,000,000	2,488,753	2,421,402	1,819,737	1,363,254	714,658	262,437	254,764,144

BALANCE SHEET ITEMS								
Year	**Equity**	**Deposits**	**Repo Transactions**	**Loans**	**Current Account**	**Gross Income**	**Profit**	**Turnover**
1910	2,500,000	3,024,854	2,040,080	1,527,559	1,808,802	708,198	312,617	266,654,979
1911	2,500,000	3,240,245	2,456,741	1,161,556	4,970,352	661,395	280,878	322,840,792
1913	2,500,000	4,234,307	2,023,801	762,930	6,500,219	2,217,659	322,580	212,979,926
1920	2,500,000	9,064,280	5,185,654	344,001	10,465,959	7,426,193	2,262,216	
1921	15,000,000	12,358,121	23,240,503	1,073,552	64,768,580	12,097,051	3,789,545	
1922	10,000,000	8,146,316	28,982,613	266,935	17,944,079	13,730,037	2,885,385	2,375,977,554
1923	10,000,000	8,439,425	24,734,600	154,776	15,278,695	17,539,367	3,628,987	2,469,142,499
1926	20,000,000	33,842,096	44,678,723	1,236,195	33,677,700	27,843,530	6,679,166	6,016,336,332
1927	20,000,000	30,149,980	46,985,761	1,138,819	29,722,131	19,823,773	6,241,610	5,784,223,805
1928	20,000,000	34,093,571	43,242,232	2,373,072	25,942,743	41,909,556	6,345,623	6,403,807,183
1929	40,000,000	43,006,625	70,111,597	2,498,017	35,437,495	39,634,693	7,017,206	
1930	40,000,000	56,434,808	76,175,748	2,785,300	38,899,209	44,265,596	7,730,363	
1931	40,000,000	22,660,819	66,446,021	9,768,312	55,320,333	42,549,541	6,383,836	
1932	40,000,000	22,412,455	40,543,912	10,132,367	69,949,068	48,767,001	3,158,858	
1933	40,000,000	31,168,292	31,391,690	9,288,973	69,796,440	39,144,749		
1934	40,000,000	23,607,326	49,772,123	9,446,686	33,605,650	46,470,072		
1935	40,000,000	31,030,139	49,563,519	11,909,368	32,507,088	38,558,874	4,892,210	
1936	40,000,000	44,917,332	32,628,143	14,212,633	54,152,916	42,121,483	5,601,759	
1937	40,000,000	64,104,629	35,000,384	13,172,136	74,923,410	43,041,737	6,621,470	
1938	40,000,000	89,906,108	45,256,245	10,323,719	98,499,452	51,843,234	7,580,880	
1939	40,000,000	111,390,590	41,167,059	8,463,747	146,841,946	56,740,200	10,209,451	
1940	40,000,000	281,008,308	33,208,378	8,413,601	254,432,291	67,276,303	14,413,823	
1941	40,000,000	304,942,732			273,407,993		14,420,408	
1942	40,000,000	257,044,798			278,686,336		6,804,939	
1943	40,000,000	287,862,436			259,083,708		7,874,934	
1944	40,000,000	359,183,196		_	292,153,618		3,915,138	

Sources: *Belgrade Cooperative, Inc. (1882-1944). Annual report: Prepared for board of shareholders. Fund 759, Folders 1-3; Belgrade Cooperative, Inc. (1907). Report: Twenty-fifth Anniversary*

d. Summary of Findings Derived From Quantitative Analysis of Primary Data

The quantitative analysis of the Belgrade Cooperative's performance shows constant and stable growth in the 62-year period from1882 to 1944 - except for World War I (1914-1918), when the Cooperative was virtually shut down (Table 1) - thus demonstrating the continuity in its process of institutionalization. In the period after World War I, beginning in 1920, the Cooperative grew dramatically in all business areas (Table 1), and this continued until 1944.

Therefore, while the Cooperative Association's business portfolio changed,its institutionalization exhibited continuity. This supports Hypothesis 3 of the proposed model.

V. DISCUSSION

The analysis of Weifert's institutional work, based on secondary and primary data and the quantitative representation of narrative analysis, shows that,in its first eight years, Djordje Weifert laid a firm foundation for the Belgrade Cooperative, thanks to which the business was able to successfully expand after his departure (Table 1). He not only established one of the most important institutions for Serbian merchants, workers, and entrepreneurs, but also aided the industrialization of the country. Over the twenty-five years following the formation of the Belgrade Cooperative, saving money in banking institutions became the expected and usual thing to do, which had not been the case prior to the formation of the Cooperative (BC, 1910, p.52). During these 25 years it was very influential in socio-economic development and the establishment of a modern economy, and in keeping money within the country's borders (BC, 1910, p.54). The organisation and solid foundation of the Belgrade Cooperative established by Djordje Weifert's institutional work was so effective that it was not dependent on his leadership. Through his leadership, banking and loans were regulated in Serbia, which directly influenced economic stabilization.

Djordje Weifert's institutional work and dedication to the idea of forming a financial institution in Serbia that would be of benefit to its people by helping them save money and obtain credit, proved tremendously rewarding for the country. In the Belgrade Cooperative for Mutual Aid and Savings he established a resilient, sustainable institution. In his institutional work he shifted from commercial to social entrepreneurship and acted as a steward to create a new cooperative for mutual aid and savings, whose purpose was to provide assistance to the lower and middle classes.

In the early stage of Serbian industrialization the country's economic system was unregulated. Djordje Weifert was one of a few influential and powerful people who were capable of implementing the idea of a Belgrade Cooperative for Mutual Aid and Savings.

Djordje Weifert chose to found the Belgrade Cooperative because he understood the value of such an institution to the development of an economically unstable country, and knew that he could bring it to realization with his entrepreneurial background and institutional work. His success is reflected in the fact that the Cooperative was formed with domestic capital, and that the it motivated the government to form the National Bank of Serbia and fund it in the same way. Djordje Weifert's lasting imprint secured the success of the Cooperative many years after his move to the National Bank. The National Bank did not compete with the Cooperative but, when necessary, provided it with significant loans to fulfil its obligations to its stakeholders (BC, 1910, p.52).

VI. CONCLUSION: PRACTICAL IMPLICATIONS, ACADEMIC CONTRIBUTION, LIMITATIONS, AND FURTHER RESEARCH

The findings of this study's narrative analysis support the main research claim that the main motivator of Weifert as a commercial entrepreneur was his desire to act as a steward and create new institutions though social entrepreneurship. The narrative analysis of primary and secondary data indicates that a significant amount of institutional work was performed by Weifert as he moved from commercial to social entrepreneurship to create a new bankers' cooperative during early Serbian industrialization. Thus the proposed model is supported, as the quantitative representation of the narrative analysis illustrates how Weifert exploited specific opportunities to successfully form new institutions, including financial cooperatives and trade associations. That Weifert's institutional work blending commercial and social entrepreneurship was successful is evidenced by the initiation of the formation of a bankers' cooperative,which offered new institutional capacity for Serbian economic growth, thus changing the mindset of the Serbian business community regarding the social benefit of credit and mutual assistance. Weifert's sequential commercial and social entrepreneurship took place during the early industrialization of independent Serbia, but left a lasting imprint of institutional sustainability, as shown in Table 1ofthis study.

Only a handful of studies have examined the relationship between institutional work and social entrepreneurship in the formation of new institutions in the early stages of national industrialization. This study used the exemplary case of Djordje Weifert to illustrate how his commitment to achieving the important goal of forming a bankers' cooperative was socially embedded. This embedding is captured by the study's dense narrative analysis,which describes critical links between Weifert's social-entrepreneurial actions and his institutional work performed during the early stage of Serbia's independence and industrialization.

In terms of limitations of the analyzed material, I recognize that the primary and secondary sources of data relating to Weifert's stewardship and entrepreneurial institutional work provide a somewhat limited basis for testing the proposed model. Also, as the archives have gone through the hands of custodians that were ideologically for and against Weifert, some of the original documents may have been lost. Moreover, using a single case study may limit the validity and reliability of the interpretation of the historical documents related to Weifert. Future research of entrepreneurial institutional work in Serbia should examine other Serbian entrepreneurs involved in the formation of the first Serbian institutions, such as Milos Savcic, who initiated the formation of the first Serbian Association of Insurers.

REFERENCES

Alvord, S.H., Brown, L.D. and Letts. C.W. (2004), "Entrepreneurship and societal-transformation: An exploratory study", The Journal of Applied Behavioral Science, Vol. 40, No. 30, pp. 260-282.

Barley, S.R. and Tolbert, P.S. (1997), "Institutionalization and structuration: Studying the links between action and institution", Organizational Studies, Vol. 18, No. 1, pp. 93-117.

Battilana, J., Leca, B., &Boxembaum, E. (2009). How actors change institutions: towards a theory of institutional entrepreneurship. In J. P. Walsh & A. P. Brief (Eds.), *Academy of Management Annals*, vol. 3: 65–107.

Belgrade Cooperative, Inc. (1891). Annual report: Prepared for the ninth board of shareholders on March 15, 1882. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1895). Annual report: Prepared for the thirteenth board of shareholders on February 11, 1886. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1898). Annual report: Prepared for the sixteenth board of shareholders on March 14, 1899. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1900). Annual report: Prepared for the eighteenth board of shareholders on February 18, 1901. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1903). Annual report: Prepared for the twenty-first board of shareholders on February 15, 1904. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1905). Annual report: Prepared for the twenty-third board of shareholders on February 19, 1906. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1909). Annual report: Prepared for the twenty-seventh board of shareholders on February 7, 1910. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1910). Annual report: Prepared for the twenty-seventh board of shareholders on February 6, 1911. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1911). Annual report: Prepared for the twenty-ninth board of shareholders on February 5, 1912. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1913). Annual report: Prepared for the thirty-first board of shareholders on February 16, 1914. Retrieved from Archive of Yugoslavia, Fund 759, Folder 1.

Belgrade Cooperative, Inc. (1920). Annual report: Prepared for the thirty-second board of shareholders on March 20, 1921. Retrieved from Archive of Yugoslavia, Fund 759, Folder 3.

Belgrade Cooperative, Inc. (1921). Annual report: Prepared for the thirty-third board of shareholders on March 23, 1922. Retrieved from Archive of Yugoslavia, Fund 759, Folder 3.

Belgrade Cooperative, Inc. (1922). Annual report: Prepared for the thirty-fourth board of shareholders on February 25, 1923. Retrieved from Archive of Yugoslavia, Fund 759, Folder 3.

Belgrade Cooperative, Inc. (1923). Annual report: Prepared for the thirty-fifth board of shareholders on February 24, 1924. Retrieved from Archive of Yugoslavia, Fund 759, Folder 3.

Belgrade Cooperative, Inc. (1926). Annual report: Prepared for the thirty-eighth board of shareholders on February 6, 1927. Retrieved from Archive of Yugoslavia, Fund 759, Folder 3.

Belgrade Cooperative, Inc. (1927). Annual report: Prepared for the thirty-ninth board of shareholders on February 12, 1928. Retrieved from Archive of Yugoslavia, Fund 759, Folder 3.

Belgrade Cooperative, Inc. (1907). Report: Twenty-fifth Anniversary of Belgrade Cooperative. Retrieved from the Archive of the National Bank of Serbia.

Bruton, G.D., Ahlstrom, D., and Li, H.L. (2010). Institutional theory and entrepreneurship: Where are we now and where do we need to move in the future? *Entrepreneurship Theory and Practice*.

Dacin, P.A., Dacin, T., M., &Matear, M. (2010). Social Entrepreneurship: Why we don't need a new theory and how we move forward from here. *The Academy of Management Perspectives*, Vol. 24 No. 3, pp.36-56.

DiMaggio, P. J., Powell, W. W. (1983). The iron cage revisited: institutional isomorphism and collective rationality in organizational fields. *American Sociological Review*, Vol.48, pp.147-160.

Garud, R., Hardy, C., & Maguire, S. (2007). Institutional entrepreneurship as embedded agency: Anintroduction to the special issue. *Organization Studies*, Vol. 28 No. 7, pp. 957-969.

Hayek, M. (2012). Control Beliefs and Positive Psychological Capital: Can Nascent Entrepreneurs Discriminate Between What Can and Cannot be Controlled? *Journal of Management Research*, Vol. 1, No. 1, 23-33.

Hayek, M., Harvey, M. (2011). Attention deficit/ hyperactive disorder as an entrepreneurial 'marker' among family business members: A social learning perspective, *Journal of Family Business Management*, Vol. 2, No. 1, 56-65.

Hayek, M. & Salem, R. (2011). A Conversation with the Pizza Princess: Diane Barrentine on Entrepreneurial Leadership, *Journal of Applied Management and Entrepreneurship* Vol. 16, No. 2, 96-104.

Humphreys, J., Pane-Haden, S., Hayek, M., Einstein, J., Fertig, J., Paczkowski, W. & Weir, D.(2012). Entrepreneurial stewardship and implicit CSR: The responsible leadership of Lillian SheddMcMurry, *Proceedings of the 2012 Academy of Management Meeting*, Boston, MA.

Ilic, S., Jerkovic, S., and Bulajic, V. (2011). Djordje Vaifert: Vizionaripregalac, National Bank of Serbia: Belgrade, Serbia.

Leca, B., &Naccache, P. (2006).A critical realist approach to institutional entrepreneurship.*Organization*, Vol. 13 No. 5, pp. 627-651.

Maguire, S. (2007).Institutional Entrepreneurship. In Hardy, C. & Maguire, S. (2008). *Institutional entrepreneurship. The Sage Handbook of Organizational Institutionalization*:198-217.

Maguire, S., Hardy, C., & Lawrence, T. (2004). Institutional entrepreneurship in emerging fields:HIV/AIDS treatment advocacy in Canada. *Academy of Management Journal,* Vol. 47 No. 5, pp. 657-679.

Mair, J., & Marti, I. (2009). Entrepreneurship in and around institutional voids: a case study from Bangladesh. *Journal of Business Venturing,* Vol. 24 No. 5, pp. 419–435.

Milleker, F. (1925/2009).PorodicaWeifertipivara u Pančevu, Fond Djordje Vajfert: Pancevo. Serbia (translated from German by Sonja Krause)

Sharir, M., & Lerner, M. (2006).Gauging the success of social ventures initiated by individualsocial entrepreneurs.*Journal of World Business,* Vol. 41, pp. 6–20.

Short, J.C., Moss, T.W. and Lumpkin, G.T. (2009), "Research in social entrepreneurship: Pastcontributions and future opportunities", *Strategic Entrepreneurship Journal*, Vol. 3, pp. 161-194.

Taylor, R. (1971). The credit union as cooperative institutions, *Review of Social Economics*,Vol. 54, no. 1, pp. 89-98.

Tracey, P., Phillips, N., and Jarvis, O. (2011). Bridging institutional entrepreneurship and thecreation of new institutional forms: A multi-level mode, *Organization Science*, Vol. 22,no. 1. pp. 60-80.

Voronov, M., & Vince, R. (2012).Integrating emotions into the analysis of institutional work.*Academy of Management Review*, Vol. 37 No. 1, pp. 58-81.

Yin, R.K. 2003.*Case study research*(3rd Ed.). Sage: Thousand Oaks, CA.

Wiklund, J., Davidsson, P., Audretsch, D.B., & Karlsson, C. (2011). The future of entrepreneurship research.*Entrepreneurship: Theory & Practice,* Vol. 35 No. 1, pp. 1-9.