ECONOMIC POLICIES IN INTERWAR EAST CENTRAL EUROPE: FREEDOM AND CONSTRAINTS OF ACTION

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This paper is concerned with the economic policy of the countries East of the Elbe and along the Danube: Poland, Czechoslovakia, Hungary, Romania, Yugoslavia and Bulgaria. Their different levels of industrialisation show a marked West to East-Southeast gradient of economic development. Only Czechoslovakia's economy did not conform to that of the other relatively economically backward Central-East and Southeast European countries but progressed on a pattern similar to West European economies.

The economic policy of Central and East European states in the interwar period developed in connection with international capital-, credit and trade movements which were decisively determined by the leading industrial nations. Although the Great Powers accepted the political reality of the existence of the new states in Central and Southeastern Europe, they regarded them as a single unit in relation to their own economic interests. At the same time they were to serve as a cordon sanitaire, on the one hand, against the danger of Bolshevik penetration from Soviet Russia, and on the other, against renewed Mitteleuropa aspirations of Germany. Only within this objective framework existed certain possibilities for the small agrarian countries, as well as for the industrially relatively more advanced Czechoslovakia, to pursue an economic policy in accordance with their own interests, either individually against each other or in varying constellations cooperating with each other.

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After attaining formal political independence the successor states largely adopted economic nationalism as an official policy. In their endeavour to build a viable capitalist economy the individual governments employed their administrative and legislative powers in order to strengthen their national and political position. The new states sought the support of the Allied Powers in their efforts to stabilize their political and economic systems, and later leaned heavily financially on the West in their endeavour to arm and industrialize.

During the two decades, bounded by Two World Wars, the Central-East and Southeast European states were drawn more closely into the international economy than before 1914 and thus they were caught up in the competitive struggles of the great industrial powers. Their economic and social policies were influenced decisively by factors impinging upon the states situated in the region between Germany and the Soviet Union from outside. In the first decade government policies were dominated essentially by the repercussions of the October Revolution of 1917 in Russia and the outcome of the First World War, and governed by the terms and conditions of the Versailles Peace Treaties. Consequently, their economic policies had to fit into the realities of the Versailles system. Central and Eastern Europe, formerly the main area of mainly German but also Austro-Hungarian influence, was included in the political, financial and capital spheres of interest of the Entente Powers.

State policies in the second decade of the interwar period were overwhelmingly shaped by the impact of the world economic crisis and the rise of Fascism in Europe. The shock of the economic crisis followed by the mounting threat of the Third Reich set in motion the gradual disintegration of the political and economic structures which had determined economic policies in the 1920s and led to their complete breakdown after the Munich Agreement of 30 September 1938.

Towards the end of the 1930s the competitive struggle between the Great Powers in the region was exacerbated as National Socialist Germany directed its Grossraumwirtschaftspolitik primarily towards the East. In this way a wide gap developed between the dominance of credit and capital investment of the Western Democracies, on the one side, and the rising share of Germany in the foreign trade of the Central-East and Southeast European agrarian states, on the other side.
Within this framework which I have tried to sketch in broad outlines, I should like to make an attempt to illustrate the serious constraints and the limited freedom of action in which economic policies of the small nations were able to develop. As this is an almost inexhaustible topic, I shall discuss three aspects which, I believe, belong to the main problems of the here examined states and which were, although in various degrees of intensity, common to them. They are:

1. Land hunger and land reform
2. Lack of capital and the quest for capital
3. Market problems and trade policy

II

Land Hunger and Land Reform

The War had left a trail of devastation caused by neglect, requisitioning and outright destruction on the land. Within the newly drawn borders of the individual states the dismal situation in agriculture was exacerbated by territorial changes which highlighted the great differences in land tenure, ranging from the latifundia system in the Balkans, over large aristocratic estates in Central-East Europe, to semi-feudal tenancies and dwarf peasant holdings everywhere - most numerous in Bulgaria - to viable peasant farms and agricultural enterprises in the Czech Lands. Greater awareness of the gross inequalities emphasized social tensions. These again were enhanced by national enmities since peasants, as a rule belonging to the nationalities who recently had become the decisive element in government (Poles, Czechs and Slovaks, Romanians, Serbs and Croats), were faced with alien landlords (mainly of Russian, German, Austrian, Hungarian or Turkish origin) who had been part of the former ruling elites. Concurrently with the decline in agriculture existing social problems were accentuated, above all, land hunger, landlessness, and pauperism. The war had strengthened the peasants' consciousness as well as their political parties and the Bolshevik Revolution had deeply influenced the peasantry's urgent demand for radical redistribution of the land.

These pressing circumstances made land reforms inevitable, quite apart from the economic necessity of changing land distribution to try and achieve greater efficiency in agricultural production as a vital background
to industrialization. The very first step in state intervention taken by all new governments in Central and Southeast Europa consisted of land reforms which received legislative priority.1

The implementation, administration and execution of land reforms, generally entrusted to special government institutions, became an integral part of social and economic policies of the Central-East and Southeast European states during the 1920s and continued to do so practically throughout the whole interwar period.2 Government Acts to distribute land were initiated mainly for political reasons to meet, at least formally, the peasants' revolutionary demands but in the course of their fulfilment legal, social, national and economic aspects came into play. In the legal sphere the abolition of the last feudal remnants strengthened individual/private ownership and the marketability of land. In the social sphere some of the most obvious inequalities were removed, war veterans, orphans and widows, and refugees were settled on allotted land, their claims receiving priority. At the same time national sentiments were rewarded by transferring landed property from alien owners into indigenous hands; loyal citizens were resettled in strategically sensitive frontier districts. However, compensation to former owners had to be paid in every country. Undoubtedly, social cause and effect of land reforms can be regarded as paramount, but their economic significance cannot be underrated. Through them the structure of land ownership was changed to a greater or lesser extent in every country by state intervention.

Although such shifts in property relations made hardly any net contribution to total gross capital formation they were part of a restructuring process in the region's economies with widely varying results. From the point of view of economic growth the most positive results were achieved in Czechoslovakia where the medium-sized unit in agricultural holdings was strengthened which increased efficiency in producing for the market, whilst in other countries this category of holdings remained of little economic significance. In Romania many large estates survived but, at the same time, the number of poverty-stricken small- and dwarfholders rose sharply. In Poland and, especially in Hungary, large estates remained predominant and, therefore, also the great aristocratic landed families remained an important political factor. On the same basis of assessment least economically effective were the reforms in Yugoslavia and Bulgaria as they further increased the incidence of subsistence agriculture on
small and dwarf plots of land. Thus the non-market sector of those economies tended to grow. 3

Since land reforms were introduced essentially as a political necessity arising out of the turmoils of the years between 1917 and 1919, they were not conceived primarily as a policy of modernization of agriculture. Therefore, on the whole, state policies connected with land reforms failed to stimulate technical improvements in order to increase agricultural productivity. The general lack of capital as well as the lack of a comprehensive agricultural policy were responsible for the failure to create sufficient agricultural credit for productive investment. The land reforms did succeed in preventing a revolution of the peasants, but they failed to overcome the scissors between agriculture and industry in the Central-East and Southeast European agrarian economies in the interwar period.

The inadequacy of the agrarian policy of the successor governments slowed down industrialization—except in Czechoslovakia—in spite of the fact that all these states pursued an economic policy favouring industrial development.

III

Lack of Capital and the Quest for Capital

Seen historically, the climate for domestic capital accumulation has been continually unfavourable in Central-East and Southeast Europe practically until the mid-twentieth century. As a result of the First World War the existing chronic deficiency in domestic capital supply deteriorated further. The breakup of the Habsburg Monarchy emphasized the uneven distribution of resources and levels of industrialization inherited by the successor states. Similar disparities existed in Poland and Yugoslavia whose territories consisted of different areas of former empires. The generally limited possibilities of domestic capital formation visibly decreased. 4

At the same time as the demand for capital rose dramatically, not least because of the rapid depreciation of currencies during the postwar inflations, the small states found increasingly harsh conditions in their search for capital. 5 They sharply competed for credits and investments from the Entente nations. In this unfavourable climate their economic policies could only be conducted under heavy constraints as the question of
how foreign capital was to be obtained became critical for their own economic development.

What were the constraints under which the various successor governments functioned and how much freedom of action remained to them to strengthen the capitalist elements in their economies?

Principally the problem was to support the relatively weak entrepreneurial class by applying an independent domestic economic policy. Considered from this point of view; firstly in the short run, endeavours of the working class towards socialization of industry were to be prevented; secondly, in the medium term, the problem of alienation of assets was to be solved by the repatriation of industrial and bank capital; and thirdly, in the long run, legislation in furtherance of industrial production was to accelerate the rate of industrialization.

Factors - such as peasant unrest - which had necessitated swift action in the agricultural sector demanded state intervention in the industrial field. Most immediately, as a result of civil wars and uprisings in Eastern Europe, strong pressures from the working population urging socialization endured, which in contemporary terms meant the transfer of private ownership of large factories and big banks into the hands of the state. Notwithstanding revolutionary demands in all states under discussion here government policy was successful in replacing socialization with nationalization by legally enforcing the transfer of foreign (former enemy) owned property wherever possible into domestic ownership, preferably into the hands of the ethnic majority whose interests the state chiefly represented. This did not mean transfer into state ownership but the successor states belonging to the Allied and Associated nations could count on the strong wave of national feelings, which accompanied the achievement of independence, and demand the 'Czechoslovakization', 'Polonization', 'Yugoslavization' and 'Romanization' of property. This was to be realized by the purchase of shares in enterprises and banks from their foreign owners under the legislative process known as Nostrification. At the same time the seat of these firms and banks were to be transferred from abroad to the territory of the new states. The Czechoslovak government pursued nostrification most consistently, in Romania and Yugoslavia state property increased through nostrification, while it did not constitute and important part of government policy in Poland. Such redistributions of property became feasible through Article 297 of the Versailles Peace Treaty applicable to German citizens.
and Article 249 of the Treaty of St. Germain and Article 232 of the Treaty of Trianon in case of Austrian and Hungarian nationals. Nostrification can be seen as an expression of an independent economic policy by the successor régimes in the first phase of their existence.

The instrument of nostrification was primarily resorted to, in order to break the umbilical cord with Vienna and Budapest, and in Poland's case, also with Berlin. It could not solve the capital shortage in the successor states because it did not at first produce new funds; on the contrary, compensation had to be paid for shares. Under conditions of general capital shortage, however, not even the strongest domestic financial groups possessed sufficient resources to obtain majority holdings in leading industrial enterprises and banks whose head offices were abroad, mostly in Vienna. Therefore foreign capital—mainly from West European industrial and financial groups—was encouraged, officially and unofficially, to participate in the nostrification of big business. Moreover, the sale of shares of leading industrial enterprises and commercial banks to foreign investors provided the new states with a guarantee against the popular demands to socialize armament factories and big firms in heavy industry. Therefore, not only shifts in the distribution of ownership from foreign to domestic entrepreneurs but also from former enemy alien to contemporary friendly foreign investors took place. In this way new economic ties, above all, with London, Paris and New York were forged, and existing relations intensified.

There could, of course, be no nostrification in the vanquished states. On the contrary, the Austrian economy was severely damaged by the transfer of head offices of limited companies (Aktiengesellschaften) to the new national states. There, instead of a boost to national consciousness defeat brought loss of confidence and doubts in the viability of the diminished Austrian economy. But in Hungary economic nationalism was underpinned by the victory of the counter-revolution as all measures of the Hungarian Soviet régime were reversed. While this policy was not able to solve the problem of capital shortages it nevertheless constituted a step in the direction of building up the credit worthiness of the newly established Regency. At the same time the Hungarian government reverted to the prewar policy of direct encouragement of industry from which both domestic and foreign investors were able to benefit. A similar path was followed by all other successor governments which proffered preferential treatment of industrial activity through their budget mechanism and through
legislation in furtherance of industry. Industrial enterprises were favoured by means of duty-free imports of machinery and raw materials, substantial freight reductions and tax allowances, gifts or rent-free use of state-owned land for factory buildings, long-term tax exemptions and high tariff barriers for the manufacture of goods which hitherto had not been produced in the country, and many other externalities. In spite of these policies the states increasingly had to play the role of entrepreneur, investor and customer, for domestic entrepreneurial initiatives were weak and foreign capital was not available in sufficient quantity. Lack of capital for investment remained a fundamental problem.

In the search for capital the area for freedom of action became visibly narrower, as all Central and East European states had to cope with the persistent capital shortage in their economic policy. Internal conditions necessitated land reforms, nationalization, defensive policies against impending socialization and measures in furtherance of industry. In order to carry out these policies the successor states had to have recourse to loans from the victorious industrial powers. There were, therefore, exposed to strong external constraints. Yet, these were expected, on the one hand, to contribute positively to the stabilization of the capitalist system and, on the other, to hold out prospects for further capital imports.

One of the main influences which determined the economic policy of the successor states was the system of peace treaties concluded at Versailles. This codified the changes in the balance of power brought about by the outcome of the First World War. The financial and economic conditions of the treaties constituted a new framework in which economic relations were transformed. In the course of the postwar re-division of international investment and world trade the victors won advantageous positions. Great Britain, France and the USA as the only remaining creditor states faced substantially weaker debtor countries. In this context the ways and methods of reconstruction in the lands between Germany and Russia were moulded by the decision-making powers in the Versailles system.

In the immediate post-World War 1 years there existed objective economic and specific political incentives for capital export of the Western Allied Powers to the small national states in East-Central Europe. These aspects have been largely underestimated in historiography. The new governments sought political and financial support from the leading
European Entente Powers, as they were convinced that their economies would not be viable without foreign aid and they considered Western capital as essential for their own long-term economic development. But also in the short-term they most urgently needed loans to stem their rising budget deficits and to halt galloping inflations.

On the supply side funds were available for investment as they had accumulated during the war years in the economies of the Great Powers and were seeking profitable outlets, while the direction and amount of their deployment remained essentially under government controls. On the demand side shortages of capital were most desperate in Central- and Southeast Europe exacerbated by the urgent demand for imports of food and raw materials. Domestic entrepreneurs were prepared to offer suppliers from the Entente countries shares in their finns in place of payment in order to keep production going under the pressure of the constantly shrinking value of currencies during rising inflation. Indeed, prospective investors were encouraged to take advantage of the inflationary situation by bankers and industrialists and, above all, by politicians of the Central-East European states. In this way a buyers' market emerged where the Central and East European countries competed for capital imports from the Entente Powers. In striving for foreign investments and loans the governments, particularly of the defeated states, expected in return for favourable treatment, especially of British and French financial groups, (such as low prices of shares and high interest rates for hard currency credits) that certain advantages would accrue to them by mitigating the rigorous conditions of the Versailles treaties, or by alleviating the expected burdens under consideration by the Reparation Commission and, most desired of all, by gaining assistance in the procurement of state loans.

The strenuous efforts of the successor states to attract capital did not remain without success. Seen historically, Central and Eastern Europe constituted an important link in the chain of international economic relations and therefore capital export into this area was an integral part of the worldwide operations of Britain, France and the USA, which were politically, diplomatically and economically motivated. The small states had to adapt to this pattern.

With regards to two aspects of the postwar development of Central-East and Southeast Europe the Entente Powers essentially agreed: In the
first place, Germany was to be eliminated as a serious trade rival: this included the prevention of renewed Mitteleuropa aspirations. In the second place, Central and Eastern Europe was to function as a barrier against Soviet Russia. It was also to serve as an alternative region for Western capital export, in order to replace, at least partially, the losses suffered by British and French investors in Russia.  

The period 1919 to 1924 is decisive for changes in the structure of international investments, as formerly German, Austrian and to some extent Hungarian interests were ousted by mainly French and British, but also Belgian, Swiss and Italian groups from key positions in the Central-East and Southeast European economies. In those years the interwar contours were drawn.  

The shortest and most effective way into the economic life of Central and Southeast Europe led through the big Viennese commercial banks which historically under conditions of relative economic backwardness had taken over the role of the capital market and had largely met the requirement of credit-financing industry. After 1918 they represented the most valuable assets which the virtually bankrupt Austrian state had to offer. Also the Anglo-French diplomacy and high finance considered them as promising investments, for the big Viennese banks held strategic positions in almost all branches of industry and their influence extended over all areas of the former Habsburg Monarchy and into the Balkan peninsula. At the disintegration of Austria-Hungary the Viennese banks suddenly stood at the head of multinational banks and industrial enterprises. However, at the end of the war their illiquidity stymied their ability to provide the economies of the Danubian region and in particular their own subsidiaries with credits. At the same time their stability was shaken by the nostrification policy of the successor states and by hyper-inflations. Therefore they sought to restore their financial soundness with the aid of Western capital.  

Between 1919 and 1922 the eight largest Viennese joint-stock banks were internationalized. Two of them were converted into branches of foreign banks: the Anglo-Austrian Bank's headquarters went to London into the sphere of interest of the Bank of England. This manoeuvre prevented the fragmentation of its Central and East European concern and the Bank of England gained a foothold in the trade and finance of this region. The Austrian Länderbank became a branch of the Paris Banque des Pays de
Europe Central in order "to carry on and develop its business . . . and to assist the economic development of Central Europe . . .".\footnote{15} This French-based multinational bank which, like the Anglo-Austrian Bank, possessed its most valuable subsidiary industrial enterprises in Czechoslovakia survived until the Anschluss in 1938 and the dismemberment of Czechoslovakia in 1939. The same is true of the subsidiary of the Bank of England in Prague, the Anglo-Czechoslovak Bank.\footnote{16} The same process of internationalization proceeded also in the banking system of the other national states under political and financial pressures applied by Britain and France.

During this process of transformation, especially of the Viennese banks and their Central-East and Southeast European subsidiary enterprises, mechanisms in which constraints functioned were wholly evident. For the Anglo-French diplomacy applied strong pressures in their negotiations with the Austrian and Czechoslovak governments, mainly through alternatively promising or withholding credits, in order to achieve that the Central- and East European combine of these banks should be brought intact and in full working order into the London and Paris banking centres. None of the great Viennese banks remained a purely Austrian institute. Their Western creditors and investors expected that Vienna would regain its role as intermediary between Western and Eastern Europe. However, it soon became evident that the claim of Vienna as a financial centre in the Danube region could not be upheld.\footnote{17}

Although the aims of French and British economic diplomacy may have been similar, their motivations and interests in Central and Eastern Europe differed and this meant that the small national states were drawn into the increasing competition between the Great Powers.

In comparison to the other Great Powers France had suffered the greatest damage in her own country and also the heaviest losses of foreign investments in the wake of the October Revolution in Russia. For these reasons among others French foreign policy endeavoured to capture key positions in banking and in heavy industry of Central and Southeast Europe\footnote{18} and to secure them by alliances. Not only Germany was to be ousted from this area but also British claims were to be warded off wherever possible. Against this background one should regard the majority participations of the French concern of Schneider-Creusot in the Škoda-Works in Plzeň, the largest armament producer of Central Europe, and in the second biggest
iron and steel works in Czechoslovakia, the Baňská a hutní společnost in Třinec. The Czechoslovak works were to play the role of the formerly French-owned Putilov-Works (in Petrograd) on the East European market. With the aid of the Czechoslovak government Schneider-Creusot thus gained an important jumping-off point into the heavy industry of East- and Southeast Europe. On 22 April 1920 all capital participations of the Schneider-concern in Central and East European enterprises were concentrated in a holding company, the Union Européenne Industrielle et Financière, which exerted decisive control from Paris and which influenced economic policy in the small national states until the outbreak of the Second World War. For French foreign economic policy the capital investments acquired between 1919 and 1921 remained the country's most valuable assets in East-Central Europe during the interwar period. However, Anglo-American competition and the revisionist endeavours of Germany set limits to French policy.

Britain's interests in Central and Eastern Europe differed from those of France. British capital export into this region was to open up new formerly neglected markets for British goods. Therefore British government gave active political and diplomatic support to those representatives of the economy who were interested in the big banks and in trade and production positions, such as the explosives monopoly in Czechoslovakia, oil in Romania and the transport system in the Danube Basin. From the point of view of the global interests of interwar Britain Central and Eastern Europe was an addition to their main spheres of interest: the British Empire and Latin America. And yet, Britain played a decisive role in the economic life of this area.

In the intention of British economic diplomacy of the immediate post-war years the Anglo-Austrian Bank acquired by the Bank of England was to be the focus for the expansion of British interests in banking, the industry and trade of Central and Eastern Europe. Such considerations corresponded with the conception of the Foreign Office, the Treasury and the Board of Trade and emanated from the expectation that Vienna would be able to hold on to its function as the financial and trading centre of the Danube Basin. Austrian government and financial circles based their hopes for financial aid from Britain on this view. However, at the most oppressive stage of the hyperinflation between 1920 and 1922 when the Austrian state had nothing but its sequestered assets to pledge, Britain
withheld loans for political reasons. Neither British politicians nor British bankers were prepared to extend credits to Austria nor to organize to promised stabilization loan at the League of Nations unless they received convincing assurances from the Austrian government that its Anschluss plans had definitely been dropped and that the financial conditions of the Bank of England would be accepted and fully implemented. By August 1922 Austria's finances were exhausted to such an extent that the government addressed an urgent plea for help to Britain and the Supreme Council of the Allies in which it stated that neither the present nor any other government is in a position to continue administering the state. Within two months the Geneva Protocols were signed and League of Nations aid, under strict international supervision of the Austrian economy, promised. In every case the procurement of foreign capital by the small states was achieved at the cost of some freedom of action in their economic policy.

While capital imports as direct participating investment contributed relatively most to capital accumulation and thus influenced the course of industrialization, the foreign credits which were requested with great urgency from the very inception of the Central and Southeast European states in their quest for capital had comparatively less positive effects on industrial development.

Foreign credits to the successor states consisted largely of aid deliveries between 1918 and 1923. In addition to the absolute necessity of subsidizing food supplies for the restive, undernourished and in many areas starving populations, large state expenditure was required for the Central and East European governments' policies of pacification. Inevitably, war-induced budget deficits grew and the printing of banknotes to cover them added fuel to already inflated currencies. Credit-financed aid was followed by reconstruction and stabilization loans. While Czechoslovakia, whose government had stabilized the currency by its own efforts had no difficulty in proving its ability to pay, Hungary was concerned to demonstrate its economic stability and credit-worthiness. Poland offered its foreign creditors excessive economic and financial advantage, and Austria justified its pleas for foreign aid with the inability of its shrunken economy to survive without it.

Austria's currency was the first to be successfully and amazingly rapidly stabilized by the previously mentioned League of Nations loan at the
end of 1922. The method of its organization and control became the model for further stabilization loans of the League of Nations to Hungary in 1924 and to Bulgaria between 1926 and 1928. Among the creditors were Britain, the USA, France, Italy, Sweden, Holland, Belgium, Switzerland and Czechoslovakia.  

In the implementation, organization and procurement of the League of Nations loans which were administered by the Financial Committee of the League, the decisive role was played by British economic diplomacy led by the Governor of the Bank of England, Montagu Norman. In his view stabilization in Europe was to be achieved by a re-establishment of 'normal' prewar conditions; above all by the return to the gold standard, by the construction of a central bank network, and the restoration of free trade. On the basis of this concept it was expected that the receiving countries would, firstly, found central banks with a monopoly of issue, secondly, aim at balancing their budgets, and thirdly, use the loans strictly for the reconstruction of their currencies. As collateral the debtor countries had to pledge their state-owned properties, their monopolies and their revenues. All government measures had to be supervised by a League of Nations appointed General Controller who remived full powers by the parliaments of the receiving states and whose seat was to be in the respective capital cities as long as it took to balance budgets and to secure the debt service for the League loans. These procedures imposed substantial constraints on the freedom of action of the successor states as their currency and financial policies were placed under Western, mainly Anglo-American supervision.  

As stabilization loans were largely applied to balancing budgets their direct effect on industrial development was not very significant. Indirectly the League of Nations loans aimed at the integration of the new economies into the international currency system and thus into the worldwide financial and trade relations which centred on London and New York. An essential part of this process of adaptation consisted of far-reaching agreements about repayments of prewar and war debts. For the Central and East European national states the clarification of international debts signified a firmer basis for further short- and long-term credits. In spite of their nationalistic economic policy and their legislation in furtherance of industries the national states neither made use of the relatively short but favourable climate in the early period of inflationary development nor did they utilize the admittedly limited advantageous
possibilities given by the stabilization loans to conduct a conscious policy of restructuring their economy in accordance with the post 1918 realities. In the short term favourable terms of trade in the second half of the 1920s contributed to the politico-economic consolidation of the Central- and Eastern European agrarian countries; yet, in the long run the panacea remained the procurement of foreign capital, protectionism and state subsidies for industries - an economic policy largely influenced by constraints which did not greatly alleviate the structural weaknesses in their economies but, on the contrary, was conducive to reproduce them.

International investments so coveted by the capital-starved successor states, whether in the shape of credits or direct foreign participations in the capital of banks and industrial enterprises, reached their peak of the interwar period in 1930. With the onset of the economic crisis investment activity abated and the total of direct foreign investment declined somewhat, but the distribution of direct long-term participating investment according to countries of origin remained essentially unchanged until the Munich Agreement of September 1938. With regard to Central-East Europe this meant that about 75% of total foreign investment originated in Western Europe. Britain and France held either first or second place in the rank order of foreign investors, while Germany, which was leading before 1914, took up the fifth place on average. 30

After 1929 contributions by foreign investors to domestic capital formation in the small states practically ceased. Where there had been a certain marginal surplus or at least a balancing of flows before 1929, outgoing interest and dividend payments exceeded capital inflows in the subsequent years, and from 1932 capital moved out absolutely from all these countries. None of them was able to cover their outgoings with export surpluses, except Czechoslovakia, but she had to reduce her capital exports simultaneously. Although massive state intervention, particularly exchange controls and strict foreign trade regulation did lead to export surpluses, these proved to be insufficient fully to meet capital claims and commitments for interest and dividend payments.

Under the prevailing economic conditions in Central-East and Southeast European countries very little of this type of capital import had contributed to their industrial development because - with the exception of Czechoslovakia - roughly more than three quarters of the total foreign loans contracted in the interwar period were put either to cover budget
deficits, consumption uses or prestige spending including excessive military expenditure, as well as to convert old debts repeatedly into new ones. Perhaps the most positive feature of Eastern European government borrowing was, on the one hand, that some part of these public loans was used for infrastructural investment and, on the other hand, that some of the funds used for state expenditure trickled into industry. But this investment activity did not absorb the major part of interwar credit. Basically, the input of foreign capital was neither sufficient to generate sustained economic growth nor did its presence provide a viable and secure home - or export market for any of the countries. The result of the policy of procurement of foreign capital was, that industrialization was slow and tariff walls grew higher. 31

IV

Market Problems and Trade Policy

In the wake of the world financial crisis practically all capital imports dried up which exacerbated the chronic shortage of capital in the Central and Eastern European countries. Their economic problems could not be bridged by further credits, they could only begin to be solved by intensifying their endeavours to achieve a favourable balance of trade by boosting exports and curbing imports. Consequently, as credits ceased, the search for markets became a priority in their economic policies, at a time of a shrinking world market.32

Through the narrowing of foreign markets autarchic policies were enhanced by militant nationalism and dictatorial regimes in the region. Indeed, the comparatively free market economy of Czechoslovakia, the only remaining democratic state of a Western type in this area, was one of the hardest hit by the crisis and recovery was slower than in the predominantly agricultural economies of Southeast Europe.

The shift in emphasis of economic policy from procurement of credits and investments to inducement of exports intensified state interventionism in the successor states from 1931. One by one the Central East and Southeast European debtor states created agrarian monopoly organizations through which they managed agricultural credits and exports; international payments came under total state control to prevent the de-
preciation of the currency and the flight of capital; and foreign trade was subordinated to complete state supervision through exchange controls to further exports and keep imports within the limits of a system of priorities.

Similarly, intensive state intervention was to meet problems of decreasing demand on the home market by cartel legislation, forced syndicalization and direct state entrepreneurship. Economic activity of the state was not seen any more as a temporary measure until things returned to 'normal' but became accepted practically and theoretically as a political necessity.

The small states did not pursue a new economic policy but they intensified the already existing autarchic tendencies. As agricultural tariffs were imposed or increased by industrial states, industrial duties were raised by agrarian countries; thus tariff levels doubled and trebled and in Bulgaria's case even more than quadrupled.33

Where were the agrarian economies of Central East and Southeast Europe to find markets for their main export commodities? Their chief creditors and investors (Britain, France and the USA) restricted access to their own home, colonial and dependent markets even further in the 1930s than in the 1920s,34 and by their participation in industry and banking of the small economies they were indirectly extracting a share in the export-orientated business of these states.35 This represented a crucial handicap for the weaker Central-East and Southeast European economies, since the possibilities of paying their debts with commodity exports to the creditor states remained severely limited.

The Great Powers, although aware of the distressing market problems of the region - were unable and unwilling to agree on a common approach to alleviate the situation. All plans of economic cooperation were scuttled by opposition from Germany and Italy and feigned disinterestedness from Britain. Britain and France recognized the need to establish inter-Danubian economic cooperation, but in 1931 these considerations faded into the background because of Germany's move towards a customs union with Austria.36 They were not prepared to tolerate such efforts which not only looked like a step in the direction of an Anschluss but would have broken all the political, financial and business ties built up within the Versailles system. While Britain consistently asserted her most-favoured-nation status, she was ready to grant certain concessions to trade among
the successor states as long as other Great Powers, especially Germany, remained excluded from these advantages. She preferred to extend greater support to the revisionist states such as Austria and Hungary in order to prevent French domination of the area. France, on the other hand, was interested in stabilizing the economies of the Little Entente, Czechoslovakia, Romania and Yugoslavia, and thus preserving as much of the Versailles system as possible. Even had any of the proposals, for instance of an inter-Danubian economic cooperation, succeeded the market of the predominantly industrial states of Austria and Czechoslovakia would only have absorbed a limited amount of agricultural produce from Southeast European countries. But it was particularly in Germany's interest to prevent any agreements on mutual trade preferences in an area where her economic influence had had to retreat after 1918. Germany's policy in Central and Eastern European economies aimed at undermining the French security system. Particularly Czechoslovakia was to be isolated for she was regarded as an obstacle to German economic expansion towards the East and Southeast. Although Germany had ceased to be a main investor she had remained the largest trading partner of her Eastern neighbours; yet her trade with those countries had been declining and reached its deepest point in 1934. While Germany's trade, especially with Southeast Europe, was a small fraction of her total foreign trade, it was precisely her desire to increase her share which led to fiercer competition. However, Germany as the most indebted nation of the postwar world and a large trading country needed markets for her industrial goods as badly as the agrarian states of Eastern Europe needed markets for their agricultural produce, but both sides needed foreign exchange just as badly.

As far as Central-East and Southeast Europe was concerned, Germany embarked upon a policy of bilateral trade agreements with the weaker Danubian countries who were attracted by her guarantees to purchase agricultural products they could not have sold elsewhere. Bilateralism succeeded more immediately with Hungary and Yugoslavia, later with Bulgaria and Romania. With the advent of the Hitler government and the implementation of the Schacht Plan in 1934 the Danubian region was to be drawn more effectively into the German sphere of influence as part of the Grossraumwirtschaft. By that time most of the Central-East and Southeast European governments, except Austria, Czechoslovakia and Poland, had subordinated their foreign trade to the clearing system generally and to
bilateral trade with Germany in particular. As they traded increasingly with Germany they were piling up credit balances in Sperrmark at especially agreed rates of exchange because their exports to Germany on average exceeded their imports from Germany between 1930 and 1938.

Thus flows of trade revived under stringent government controls but not flows of capital. Bilateralism in foreign trade obviously did not contribute to solving the problem of capital and trade flows, since the successor states were neither able to get sufficient payments in free exchange nor attract new capital in loans from abroad but still had to meet their foreign debt commitments. For this reason among others the governments of Bulgaria, Hungary and Poland, but also of Germany did not want to devalue their currencies as their debt burden would have intolerably increased. Consequently, the economically weak countries which pursued policies of exchange controls and bilateral trade, were caught up on the foreign trade scissors of declining export prices and rising import prices.

How successful was the search for markets under these constraints? Bilateralism between the weak agrarian economies and the crisis-ridden German economy seemed the only way out of the trough of the depression. But soon the expectations of both sides were disappointed as disadvantages began to outweigh the advantages of such arrangements but, on balance, it was more advantageous for Germany.

As Germany encountered difficulties in her economic policy aims in relation to East European states, the effect of economic collaboration with Germany was even more disappointing to them. The advantages that accrued to the agrarian economies from bilateral trade with Germany have been exaggerated. Most recently this argument was carried to extremes when it was stated that the weak agrarian economies of Southeast Europe exploited Germany rather than the other way round. Doubtlessly, the economies caught in the breakdown of multilateral trade and starved of capital benefited from the revival of any kind of trade and there was only Germany to turn to when agricultural prices hit rock bottom. However, taking the decade between 1928 and 1938 the expectations of the Central-East and Southeast European countries of exchanging their agricultural products for imports which would assist in their industrialization were not fulfilled. While the flows of trade from the region changed direction towards Germany the volume of trade with Germany had not reached the 1929-level by
the eve of World War II. Only Hungary and Bulgaria were drawn entirely into the German orbit in trade, to a lesser extent Yugoslavia and Romania, while Czechoslovakia and Poland reduced their trade with Germany.

As it became more obvious that bilateralism with Germany ever more limited the economic moving space of the national states they tried to extricate themselves from the German trade ensnare and develop their commerce with countries in which they could freely dispose with the proceeds of their exports, in order to obtain raw materials and machinery in which they were deficient. This was only partially possible for a large part of their foreign exchange surpluses when and if they obtained them had to be used for liquidating old debts. But the new element in the geographical distribution of Central-East and Southeast European trade between 1928 and 1938 as compared to the previous decade was the trend away from Germany to export to free exchange countries in other continents where export surpluses could be used to purchase capital goods for their industrialization. 42

While trade flows changed direction, no significant change took place in the commodity composition of exports of the agrarian countries. As Germany insisted on increased deliveries of grain and foodstuffs, the comparatively least developed countries - Bulgaria, Yugoslavia and Romania - showed the highest concentration of exports of primary products. Initially, Germany offered the agrarian countries higher than world prices for their agricultural produce but when they were forced deeper into the channels of bilateralism and the levels of their domestic prices had risen as a result, German export prices rose, or Germany tampered with the agreed exchange rates, or she reduced the quality and quantity of her exports or delayed deliveries to her Southeast European trade partners. 43 In order to get more adequate returns from Germany the governments had little choice but to demand and accept manufactured goods. Such exchanges hampered rather than furthered these countries' endeavours to industrialize. 44

Bilateral trade with Germany did not aid industrialization of the less developed economies or accelerate their economic growth to a remarkable extent as has been claimed. On the contrary, the larger Germany's share in East European foreign trade on a bilateral basis grew, the more the industrialization of the region was threatened. Indeed it was National Socialist policy to prevent indigenous industrialization as far as possible. 45
Conclusion

The economic policy of the Central-East and Southeast European states consisted, beside land reforms, above all in a quest for capital, in search for markets and in furtherance of industrialization. In the interwar period it was not successful in achieving a mutual interaction of producer goods industries and consumer goods industries which would or could have led to sustained economic growth; neither did it engender a rising effective demand on domestic markers, nor was bilateral trade with Germany conducive to a marked improvement in agricultural production and in industrial development. The limited successes which were attained in the 1930s were connected with their policy of import substitution.

Under these circumstances there existed objective limits to policies in furtherance of industrial production, because for the greater expansion of industry there was insufficient domestic and also insufficient foreign capital available; at the same time the export possibilities of the small successor economies were generally restricted, but particularly during and after the crisis of the 1930s.

During the two decades of the interwar period from 1918 to 1938/39 the freedom of action of the Central-East and Southeast European states in their economic policies was severely restricted by the existing constraints which were identified in this paper in relation to their main economic problems.

Vienna, 10 August 1985
The following dates of the landreform laws are informative: Romania from 1 to 15 December 1918; Yugoslavia on 15 February 1919; Czechoslovakia on 16 April 1919; Poland on 10 July 1919; Hungary during the revolution of 1918/19, but landreform legislation followed under the régime of Admiral Horthy in 1920, Bulgaria passed a number of laws under the peasant leader Stamboliski in 1921.


The basis was the Law for the Furtherance of Industry of 1907 which was extended by new rules and regulations by the Ilungarian government after 1918. This law did not distinguish between domestic and foreign entrepreneurs.

Just as Poland's étatisme arose out of these constraints also Bulgaria's farreaching policy of 'encouragement of industry' emanated from the weakness of the domestic capitalist entrepreneurship.

Cf. Teichova, An economic background, passim.


Teichova, 'Versailles . . . ', p. 378.
Finanzarchiv, Vienna, 6574/21, Länderbankeingabe, 22.5.1921.
Teichova, An economic background, passim.
Finanzarchiv, Vienna, Dept. II - 2530 - Motivenbericht der Anglo-bank.
Haushof-und Staatsarchiv, Vienna, London Berichte, 1921, 1922-1924.
Poland's reconstruction confirms this indirectly, but also Anglo-American-French competition raises its head during the negotiations. During the inflation in Poland in 1924 the Polish government evaded League of Nations reconstruction by accepting a French bridging loan, which was offered in order to forestall British penetration. When the Polish government experienced renewed difficulties during the second wave of inflation in 1927 Montagu Norman insisted that no credits were to be extended to Poland unless and until her government applied to the League of Nations for assistance to put her finances in order. However, with the support of the Governor of the Banque de France, Émile Moreau, and the Governor of the Federal Reserve Bank of the United States, Benjamin Strong, Poland received a stabilization loan of $62 million from a bank consortium in 1927. At the same time an American Controller was appointed who was to reside in Warsaw for three years in order to supervise the harsh conditions imposed by the loan. Cf. Zbygniew Landau, 'Polskie zagraniczne pożyczki państwowe 1918-1926' in Gospodarska Polska 1918-1939 (Warsaw, 1961).
Teichova, 'Aspects of Capital Accumulation', p. 90.


In the case of capital - but also commodity exports from Czechoslovakia - those foreign companies and banks which owned or owned shares in such enterprises and banks in Czechoslovakia also participated in the profits from Czechoslovak exports. Cf. conclusions in Teichova, An economic background, p. 380. Also observations by Philippe Marguerat, 'Le protectionnisme financier allemand et le bassin dambien à la veille de la seconde guerre mondiale: l'exemple de la Romanie', Relations internationales (1978), pp. 351-364.


Public Record Office, FO 371/21139 - Southern (Danubian) States, contains material from 1932 to 1937.

Yugoslavia's foreign trade took place almost wholly within clearing by 1932/33, also about 70% of total foreign trade of Bulgaria and Hungary, and 50% of that of Romania which kept on rising to reach 80% by 1937. Cf. Držek, Chapter 7: Foreign Trade in Kaser and Radice (eds.), Economic History of Eastern Europe.

League of Nations, Trade and Production in the Danubian States (Geneva, 1945), Appendix 1.


Contemporary debates about the economic viability of bilateral trade between National Socialist Germany and Eastern and Southeast Europe never quite subsided and have recently received renewed attention. Germany's advantageous economic and political penetration was stressed by Dörte Doering, 'Deutsch-österreichische Aussenhandelsver- flechtungen während der Weltwirtschaftskrise' in Hans Mommsen, Dietmar Petzina, Bernd Weisbrod (eds.), Industrielles System und politische Entwicklung in der Weimarer Republik (Düsseldorf, 1974), pp. 514-530; the subjugation of Southeast Europe by Germany is discussed by Charles P. Kindleberger, Foreign Trade and the National Economy (New Haven and London, 1962), p. 143, and Holm Sundhaussee., 'Südosteuropa in der nationalsozialistischen Kriegswirtschaft am Beispiel des "Unabhängigen Staates Kroatiens"', Südostforschungen, XXXII (1973, pp. 233-238; the thesis of 'informal empire' is put forward by Hans-Jürgen Schröder. 'Südosteuropa als 'Informal Empire' Deutschlands 1933-1939'. Das Beispiel Jugoslawiens', Jahrbücher für die Geschichte Osteuropas, 23 (1975), pp. 70-96, and Ivan T. Berend and György Ráni, Economic...
Development in East-Central Europe in the 19th and 20th Centuries (New York and London, 1974), pp. 278-280; while the beneficial effects of Germany's policy on her trade partners is regarded as decisive by Eckhard Weber, Stadien der Aussenhandelsverflechtung Ostmittel- und Südosteuropas (Stuttgart, 1971), pp. 11 and 33, and Wolfgang Piper, Grundprobleme des wirtschaftlichen Wachstums in einigen südosteuropäischen Ländern in der Zwischenkriegszeit (Berlin, 1961), p. 146; this is carried to absurdity when Germany's alleged sacrifices in her relations with the Southeast European economies led to an appeal to historians to examine how these small countries exploited Germany urged by Alan S. Milward, 'The Reichsmark Bloc and the International Economy' in Gerhard Hirschfeld and Lothar Kettenacker (eds.), Der 'Führerstaat': Mythos und Realität (Stuttgart, 1981), pp. 377-413. Bernd-Jürgen Wendt writes on the basis of convincing sources that they (the sources--AT.) "reduce the popular legend which even nowadays tells us of the great support the industrialization in South East Europe generally received from the Third Reich in the interwar period to its real nucleus," 'Eine Antwort of Alan S. Milward' in Hirschfeld and Kettenacker (eds.), Der 'Führerstaat', pp. 414-428. Wendt's standpoint is substantiated also by the work of David E. Kaiser, Economic Diplomacy and the Origin of the Second World War (Princeton, 1981).

42 League of Nations, Trade and Production in the Danubian States, Appendix I, p. 140.


45 Archival sources, published and unpublished, provide ample evidence of the principles pursued by National-socialist Germany in her endeavour to create a 'New Order in Europe', cf. Akten der deutschen Außenpolitik, volumes covering the period 1933 to 1938.
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