Oesterreichische Nationalbank
Eurosystem

Workshops

Proceedings of OeNB Workshops

The Experience of Exchange Rate Regimes in Southeastern Europe in a Historical and Comparative Perspective

Second Conference of the South-Eastern European Monetary History Network (SEEMHN)

April 13, 2007

No. 13

Foreign Exchange Policy in the Kingdom of Yugoslavia during and after the Great Depression

Dragana Gnjatović
Megatrend University, Belgrade

1. Introduction

Yugoslav government pursued quite liberal economic policy after the First World War. However, during the Great Depression both the government and the National Bank management were forced to rely on state intervention measures that had seen no precedent in the practice that far. These interventions were only aimed for maintaining the exchange rate stability of domestic currency. One of the key problems was a sudden foreign exchange shortage in current account transactions of the balance of payments.

The first part of the paper outlines briefly a short period of implementing the gold exchange standard in the Kingdom of Yugoslavia. In 1931, following five years of actual stabilisation of the national currency, the dinar convertibility was stipulated by law. However, the gold exchange standard implementation lasted for merely 101 days in the conditions of economic crisis.

Second part of the paper considers the reasons for a sudden decrease in the state's foreign exchange earnings during the Great Depression. One of the reasons was certainly a drop in the earnings from exports of goods and services, which was primarily a result of signing numerous bilateral clearing agreements. Another important reason for the decrease in the state's foreign exchange earnings was the fact that German reparation payments had been suspended. At the same time, the state budget was additionally burdened by obligations in foreign exchange induced by a ruling of the Permanent International Court of Justice in The Hague concerning the currency in which Yugoslavia was to repay the debts of the Kingdom of Serbia.

Third part of the paper elaborates on the dinar stabilisation key measures: temporary restrictions of imports of certain types of goods and services and temporary suspension of foreign debt repayments which, in turn, led to signing a number of conventions with foreign bond holders related to the state loans of the Kingdom of Yugoslavia.

The concluding part of the paper researches to what extent the policy of exchange rate stabilisation of the dinar during Great Depression was successful.

2. The Gold Exchange Standard

The exchange rate of the dinar at the end of 1918 and during 1919 is difficult to assess as the dinar re-emerged on the world's money markets not before May 1920. Once the First World War was finished, Switzerland took the lead on the world's foreign exchange market thanks to the stability of its currency and the freedom and flexibility of currency trade and exchange that remained intact even during the war. This is why shortly after the war and in the absence of gold in monetary transactions Swiss franc became the currency which other European currencies' stability could be most easily compared against; it also explains why Geneva and Zurich became main international foreign exchange markets. In the period May-October 1920, the exchange rate of the dinar fluctuated on the Zurich money market between 20.41 and 33.65 Swiss francs against 100 dinars. As from October 1920, the dinar sharp slump began, induced by the inflationary, deficit financing of state expenditures and replacing the former crown of the Habsburg Monarchy. Monetary circulation had soared compared to the previous year by 4.5 times and amounted to 3.4 billion dinars! From October 1920 to January 1923, the exchange rate of the dinar fell from 20.41 to 3.69 Swiss francs against 100 dinars.[1] At the same time this was the lowest exchange rate of the dinar recorded at the Swiss money markets between the two world wars.

Apart from the replacement of the crown by the dinar and the inflation of money in circulation that had been systematically induced by the state through loans obtained from the National Bank as from the liberation till the end of 1921, the conduct of private capital also influenced greatly the drop of the exchange rate of the dinar in the first post-war years. Large amounts of money in circulation created an illusion of the existence of abundant capital, which then led to an economic boost in industry, trade and banking. Various share holding companies were set up but not through investing capital but rather by means of letters of exchange and loans. In an inflationary environment, where numerous construction works were undertaken, supported by the nominal interest rate stability that led to the fall in the real interest rate.[2] It was precisely the private capital that induced the large fall of the exchange rate of the dinar during 1922, as by that time the state had already ceased to take loans from the National Bank.

[1] Narodna banka Kraljevine Jugoslavije: *Narodna banka 1884 – 1934* (*National Bank 1884 – 1934),* Belgrade, 1934, p. 165 (in Serbian).

[2] S. Secerov: *Nase finansije 1918 – 1925 (Our finances 1918 – 1925),* Progress, Belgrade, 1926 (in Serbian).

2.1. Deflationary Policy

As from 1922, inflation-based crediting of industry and trade along with the deficit financing of state expenditures ceased, and a period of conducting a deflationary policy started. The policy began by settling the issue of the state loans from the National Bank, and it continued through the National Bank's restrictive monetary policy. As early as in the beginning of 1923, the National Bank exhausted the regular legal amount of banknotes that were in circulation, so there were no possibilities for increasing bank loans to commercial banks. According to the National Bank Law from 1920, the regular amount of banknotes in circulation was not to surpass the triple value of the Bank's gold and foreign exchange reserves. So, the first post-war commercial banking crisis in the country started with the National Banks' restrictive monetary policy. Bankers protested angrily against the National Bank's restrictions. They demanded that the Law should be altered, as they argued that increasing funds allocated to industry and trade would not harm the dinar whatsoever. However, the National Bank contended that not every economic transaction should be unconditionally considered to be productive, as many industrial share holding associations were mushrooming with no real financial foundation.

During the period from 1923 to 1924, there were no new bank loans and the process of general price growth was stopped. Out of economic necessity, commercial banks and industrial companies were forced to start conducting themselves in a more realistic way and to dispense with all the unprofitable business dealings that money had been squandered on without thinking. Therefore, private capital adapted itself to a situation in which attaching value to the domestic currency had become the prime means of daily economic conduct. Owing to a quick response to these new economic conditions, commercial banks managed to go through the crisis unscathed till the beginning of 1925 when the National Bank started granting new credits . Admittedly, several industrial firms and banks went bankrupt but not as much due to the crisis but rather due to their own "unwise business operations".[3]

The new economic measures immediately reflected on the value of the dinar. The currency started recovering and till the end of 1924 the exchange rate of the dinar in Zurich was 7.45 Swiss francs for 100 dinars.

2.2. Buying off the Thirds of Foreign Exchange Earnings from Exports

Deflationary policy was implemented in the Kingdom of Serbs, Croats and Slovenes until the mid 1925, when the exchange rate of the dinar on the Zurich

[3] Z. Topalovic: "Dinarsko pitanje" ("The Dinar Issue"), *Valutna reforma u Jugoslaviji,* Napredak, Beograd, 1930, p. 9, 10 (in Serbian).

money market stood at 9.12 Swiss francs against 100 dinars. It was at this point that the National Bank and the Ministry of Finance decided to suspend measures aimed at strengthening the dinar exchange rate, as deflation threatened to paralyse domestic economy. As state finances were in order, the fiscal 1924/25 year ended with a surplus in state budget, prices had stabilised and commercial banks continued their normal functioning, all the conditions for the exchange rate stabilisation of the dinar on the world money markets had been met.

In order to stabilise the exchange rate of the dinar it was necessary but not enough to maintain its purchasing power on a proper level at home. There was also a need to maintain its exchange rate against leading European currencies abroad, with the help of certain foreign exchange measures. For maintaining the exchange rate of the dinar against major European currencies the National Bank had to possess certain financial resources, that is, a sufficient level of foreign exchange reserves. According to the Decree on the transactions with foreign exchange, brought on 31 December 1922, the National Bank secured foreign currency reserves through buying off the thirds of foreign exchange earnings from exports. Exporters of all major export products (such as all kinds of wheat, flour, bran, livestock, meat, fat, meat products, cheese, processed leather, wood, all wooden items, processed and dry fruits, excluding jam, eggs, chicken, hemp, cement, rock for cement production) were under obligation to deposit one third of their earnings to the National Bank by means of authorised monetary bureaus for buying foreign exchange.[4] The National Bank then used the foreign exchange collected in such a way to finance government payments abroad and interventions on money markets.

By means of buying off the thirds of foreign exchange earnings from exports, a foreign exchange reserve amounting to around 216 million dinars was created in 1923. In order to strengthen the dinar exchange rate this reserve was used for money market interventions in Geneva and Zurich. However, as early as in 1924, with the exports revenue growth, the Bank turned out to have merely sufficient dinar funds to buy off a third of foreign exchange earnings, which in turn could have only negative influence on its capacities for interventions on foreign exchange markets. Therefore, the dinar circulation was to be adapted to the foreign trade needs but there was no relevant legislation to do that at the time. That is why in August 1925, a new legal interpretation of the Article 20 of the Kingdom of Serbs, Croats and Slovenes National Bank Law stipulated that banknotes issued by the Bank for buying foreign exchange abroad were no longer encompassed by the

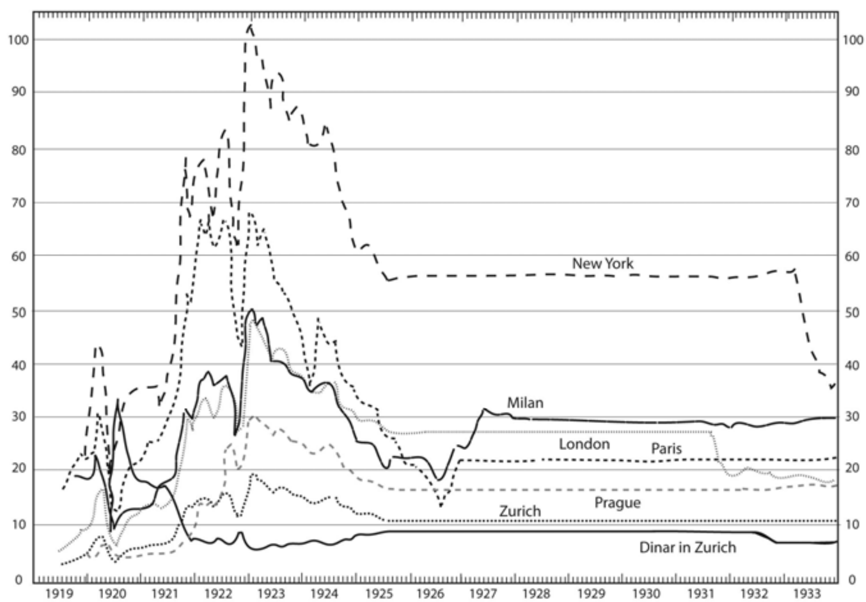
[4] G. Brasic, *Devizno-vatutni propisi i njihov uticaj na spoljnu trgovinu (Foreign Currency Regulations and their Influence on Foreign Trade),* Stamparija Drag. Gregoric, Belgrade, 1939, p. 11 (in Serbian).

regular banknote contingent. By means of this, the National Bank secured the necessary flexibility enabling its foreign exchange interventions.

2.3. *De Facto* Dinar Stabilisation

Period of *de facto* dinar stabilisation started with this new legal interpretation of Article 20 of the National Bank Law. The period lasted for entire six years, from August 1925 till 28 June 1931. In the meantime all the pre-war and war debts had been regulated, which influenced favourably the state's creditworthiness abroad and indirectly also the trust in the Yugoslav currency. Owing to its interventions on world money markets the National Bank managed to maintain the exchange rate of the dinar in the range between 9.12 and 9.13 Swiss francs against 100 dinars.

*Chart 1: Foreign Currencies Exchange Rate Changes on the Belgrade Foreign Exchange Market and Dinar Exchange Rate in Zürich (1919–1934)**



*Note: *Lines correspond to exchange rates for 100 dinars, 10 Swiss francs, 10 Czechoslovakian crowns, 10 French francs, 2 English shillings, 10 Italian liras and 1 US dollar.*

Source: V. Dugalic, A. Mitorvic, D. Gnjatovic, National Bank 1884–2004, Yugoslav Survey, Belgrade, 2004, p. 127.

Stable government finances aided to maintain the value of the dinar during the period of its *de facto* stabilisation. Sudden increase in government expenditures which accompanied the reconstruction after the war, was stopped in the 1923/1924 fiscal year. By that time, the state apparatus had been set up, the need for stringent border security measures had ceased and new state loans both in the country and abroad, were not incurred till 1931. In the period between the 1923/24 and 1929/30 fiscal years, government expenditures grew relatively slowly and stood at the level of 10.2 to 11.8 billion dinars. At the same time, government revenues rose from 9.8 to 13.4 billion dinars. Revenues generated from all sources grew alike, both from direct and indirect taxes and from the state economy. The government revenues structure did not change significantly. Fiscal revenue (generated from direct and indirect taxes) accounted for two thirds of the entire government revenues whilst revenues from the state economy constituted around one third of total government revenues. Revenues generated from indirect taxes, including monopolies and sales tax, made up three fourths of the total fiscal revenue, whereas direct taxes constituted one fourth of the total amount.[5] The increase in the government revenues was partially a proof of strengthening of the economic power of the population and economic growth during the observed period, whilst at the same time resulting from the tax system unification and modernisation.

2.4. *De Iure* Dinar Stabilisation

After the First World War all the European countries tended to maintain their respective currencies stable, as money could not act as a unit of account whilst its value was fluctuating chaotically. For the first time after the war the European business establishment that had operated devoid of any currency fluctuation issues in the pre-war period, faced grave business dysfunctions through oscillations in currency values. In the same way the war called for enormous funds, the restoration of the war-ravaged lands also required spending of huge amounts. The restoration periods varied over different countries. With the stabilisation of economic conditions and state finances across Europe the conditions for national currencies stabilisation were created too. The currency stabilisation was an indispensable step towards returning to the gold standard. However, there was no real going back to the gold standard as gold no longer *de facto* featured in transactions. During the First World War, the full currency convertibility, that is, currency exchangeability for gold was abandoned. Once currencies got stabilised after the war the value of money was again attached to gold but this time it did not envisage the exchange of banknotes for the metal. Either gold bullions (Gold Bullion Standard) or combinations of gold and foreign exchange (Gold

---

[5] Ministarstvo finansija, Ministarstvo finansija 1918 – 1938 (Ministry of Finance 1918 – 1938), Belgrade, 1939, p. 29 (in Serbian).

Exchange Standard) could serve as foundation/guarantee for banknotes in circulation. Currencies were compared against each other, not against the quantity of gold which they used to be exchanged for.

Following a period of *de facto* currency stabilisation, European countries undertook legal measures towards their *de iure* stabilisation.[6] To stabilise currency legally meant establishing the value of national currency against a certain quantity of gold. Every country that undertook this measure gave an additional stability element in foreign transactions. Currency stabilisation was either preceded by a long-term gradual strengthening of gold and foreign exchange reserves of the central bank or by means of huge foreign loans thus creating conditions for an instant and considerable strengthening of gold and foreign exchange reserves of the central bank.

Managing to maintain the unchanged exchange rate of the dinar for a number of years, Yugoslavia was amongst the last European countries to start *de iure* stabilisation of its currency in 1931. *De iure* currency stabilisation envisaged unconditionally that the total banknote contingent that was in circulation had to be covered for by a legally prescribed amount of gold and foreign exchange reserves. In order to secure such a guarantee, the Yugoslav government took a stabilisation loan from French banking consortium on 8 May 1931. The nominal value of the loan was 1.025 million of French francs in gold, with the interest rate of 7% and a 40-year repayment period. The market price of the loan was 82% of its nominal value.[7]

On 11 May 1931, the Law on Money was brought and it stipulated that the value of dinar equalled to 26.5 milligrams of pure gold. It was also legislated that the National Bank was to cover in foreign currency and gold 35% of all money in circulation. Also, the national bank was under obligation to exchange all amounts surpassing 250 million of dinars for either golden bullions or foreign exchange. According to this law, the exports of gold and foreign exchange were free, that is, the foreign exchange regime of restrictions was formally abolished. When the Law on Money came officially into effect on 28 June 1931, the gold exchange standard was formally established in the Kingdom of Yugoslavia for the first time.

Sadly, after hardly three months of applying the Law on Money (after 101 days), at the moment when both economic and financial crises were already seriously afflicting the country, the Yugoslav government was forced just like other

---

[6] Amongst the first European countries to start *de iure* stabilisation of their respective currencies were Belgium in 1926; England, Denmark, Switzerland, Italy in 1927; Norway, France in 1928 and Czechoslovakia in 1929. R. Nurkse, *International Currency Experience,* League of Nations, Geneva, 1944.

[7] Ministarstvo finansija, Zakon o odobrenju međunarodnog stabilizacionog zajma 7% od 1931. godine (Law on granting international stabilisation loan of 7% from 1931), Belgrade, 1931 (in Serbian).

European governments to reintroduce restrictions in both domestic currency and foreign exchange transactions.[8] On 7 October 1931, a new Book of rules regulating foreign exchange transactions was brought; it sustained various amendments and stayed valid till the end of the period in between the two world wars.[9] The stipulations in this Book of Rules legislated exclusively for monetary transactions whereas trade in goods remained free.

3. Causes of Foreign Exchange Shortage

Until the First World War the Kingdom of Yugoslavia had not breached any provisions of valid trade agreements by means of introducing various foreign trade restrictions. However, after the war many countries, the Kingdom of Yugoslavia being one of them, started flouting both old and new trade agreements out of necessity. Still, an important fact is that all the countries tended to adapt practical implementation of these agreements to legal environments created by trade and contractual relations, all up until a great agrarian crisis broke out, followed by a general economic crisis.

3.1. International Trade Control

As the world's agrarian crisis was getting more and more serious the tendency to liberate the international trade of numerous exports and imports war-induced restrictions was abruptly abolished.

Stringent import and export controls were indispensable national defence measures during and immediately after the war. It was paramount to ensure during the war that strategic products should not end up in enemies' hands, that is, it was necessary to make sure these products got to the allies' countries. Also, it was to be ensured that limited financial and transport resources should be used for transporting imported goods that were of paramount importance in war times.

After the German capitulation and announcing the truce all non-European countries, including Northern European countries and Great Britain started abolishing the majority of foreign trade control measures rapidly. Even though, classic trade protection measures such as customs duties based on either value or

[8] For example the British pound officially suffered over 30% value loss in autumn 1931, followed by many other currencies. On causes of such massive suspension of the gold exchange standard during the Great Depression, see Ch. P. Kindleberger, *A Financial History of Western Europe,* George Allen and Unwin, London, 1987.

[9] D. Gnjatovic, "Sto in en dan dinarske konvertibilnosti" (101 days of the Dinar convertibility), *Prispevki za novejso zgodovino,* Vol. XLVI, No. 2, 2006, p. 29 (in Slovenian).

weight of goods had become regular and constant on a considerably higher level than it was the case before the war concerning customs protective measures.

In Central and Eastern European countries import and export controls lasted several years after the war too. It took some more time to stabilise economic and political environment in these regions. In the beginning there was not enough food for domestic population, therefore food was not to be exported; all up to 1922 there were war conflicts and it was only in 1923 that new countries' borders were definitely established. Thus, it was not before 1924 that conditions for returning to free trade were met in Central and Eastern European countries.

Releasing world's trade flows from administrative obstacles led to a bloom in international trade. In the period from 1926 to 1929 the value of the world's trade was higher than that in 1913 by 40%. Increase in export-generated income created an opportunity for agrarian countries to pay off new foreign loans and for rich industrial countries new capital placement opportunities. In this way agriculture also enjoyed some of the crediting privileges that up till the world war had been an exclusive industry privilege. International annuity payments went up between 1923 and 1929 from 2,200 to 3,700 billion US dollars in gold, which speaks enough on the volume of booming international crediting in the 1920s.[10] The US became the most important creditor and American monetary public was exposed to a deluge of foreign loan bonds. Crediting became a new world's religion that was rapidly gathering followers worldwide. Both industry and agriculture were being credited, but also public and private spending. The world was living "on credit" and at the expense of some future expected income.

However, when the crisis broke out the situation changed significantly. Starting from 1928, in order to protect their agricultural and other producers countries were starting to introduce import restrictive measures regarding quantity of goods imported, asking for import permits and prohibiting the imports of some products. Countries whose economy depended primarily on exports were seriously affected by these import limitations and restrictions. As the crisis was increasing, the restrictive measures threatened to paralyse foreign trade amongst many countries completely, so starting from January 1932 a number of bilateral clearing agreements were signed. These agreements were in essence the last defence against chronic foreign exchange shortage incurred in many countries by world's trade decline.

[10] M. Nedeljkovic, Problem dugova u danasnjoj privredi ("The Problem of Debts in Today's Economy"), *Privredni letopis Zaduzbine Nikole Spasica,* Belgrade, 1936, p. 234 (in Serbian).

3.2. Fall in Export Earnings

In the period from 1929 to 1932, earnings of exports of goods and services of the Kingdom of Yugoslavia fell from 7.9 billion to 3.0 billion dinars. This drastic drop of earnings was primarily a consequence of switching to bilateral clearing agreements type of trade. At the same time, Yugoslavia was deprived from important earnings from emigrants' remittances, which dropped from 880 to 206 million dinars.

During the Great Depression, the Kingdom of Yugoslavia was forced to sign bilateral clearing agreements with Austria, Czechoslovakia, Belgium, Luxembourg, Italy, France, Switzerland and Germany. International trade in the years of crisis was facilitated owing to these clearing agreements. But given that these agreements were signed with almost all important trade partners, the state could no longer count on one half of its total foreign exchange earnings generated from exports. Also, as the crisis was progressing emigrants were sending less and less money to the country.

Table 1: Earnings on Current Account of the Balance of Payments of the Kingdom of Yugoslavia (1926–1936), in Million of Dinars

1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936
7,818	6,400	6,445	7,922	6,780	4,801	3,056	3,378	3,387	4,030	4,376
1,670	3,544	1,628	2,135	1,136	857	612	712	799	838	936
1,340	1,337	1,308	1,570	1,340	573	206	122	120	288	264
589	557	400	682	600	0	0	0	0	0	0
751	780	908	888	740	573	206	122	120	288	264
0	0	0	0	14	11	2	0	94	0	0
10,828	11,281	9,381	11,627	9,270	6,242	3,876	4,212	4,391	5,156	5,603

Source: O. Kovac: Spoljnoekonomska ravnoteza i privredni rast, IV izdanje (External Balance and Economic Growth, IV Edition), Savremena administracija, Belgrade, 1985, p. 320, 321.

3.3. German Reparation Payments' Suspension

On 30 February 1921, the Reparation commission decided that the Kingdom of Serbs, Croats and Slovenes was to be awarded in damages 120 billion German marks in gold as a compensation for damage incurred by Germany to Serbia. Though the Kingdom managed to collect merely 0.2% of the awarded damages before the suspension of reparation payments was imposed, the foreign exchange generated by these payments was still an important source of government revenues.

Germany was under obligation to compensate within 30 years for the war damage it had incurred during the war.[11] Reparation payments proved to be too heavy a burden for the German state budget so the government asked repeatedly in 1921, 1922 and 1923 for the reparation debt to be reduced and deadlines to be extended. Overburdened by paying off its reparation debt, German government found no scope for paying off its other state debts and on 31 January 1924, Germany officially stopped paying off its foreign debts "at least until war reparations were completely settled".[12] In order to protect the international payments system from collapsing the Reparation commission set up an International Financial Expert Committee on 14 November 1923 to rearrange the German reparation payments plan in line with German objective economic conditions. The German reparation payment plan formed by the Committee on 31 July 1924 was named after its chairman Charles Dawes – Dawes' Plan.

Dawes' German reparation payment plan was based on a successive increase in annual reparation debt rates beyond the basic 2.5 billion Reichsmarks annuity and in line with the projected increase in German national income.[13] In order to calculate precisely amounts of respective reparation debt annual rates the so called prosperity index was used and it was decided upon based on statistical indicators for the year before: German railway trade volume, German foreign trade volume, sugar, beer, alcohol and tobacco consumption, German budget revenue and expenditure ratio, indicators showing the level of coal and lignite consumption in Germany. It was foreseen that reparation debt payments should take roughly 62 years, and whether it was going to be a correct prediction or not depended on actual results in German economic progress. In order to ensure the implementation of the Dawes' Plan a series

[11] The Reparation Commission was set up by Article 233 of the Versailles Peace Treaty, Official Gazette of the Kingdom of Serbs, Croats and Slovenes, No 119 a, 1920, p. 80.

[12] R. Aritonovic: Reparacije i Nemacka: Na cemu nas je rat ostavio?" (Reparation and Germany: Where did the War Leave Us?"), *Ekonomist*, Belgrade, No. 1–2, 1928, p. 37 (in Serbian).

[13] R. Aritonovic: Reparacije i Nemacka: Dawesov Plan i njegove primene (Reparation and Germany: Dawes' Plan and Its Implementation), *Ekonomist*, Belgrade, no. 3–4, 1928, p. 116 (in Serbian).

of administrative institutions were established across Germany which had the role of international monitors and political controllers.

After less than four years of the Dawes' plan implementation it turned out that the plan and its solutions were unbearable burden for Germany. German economy was undergoing a deep depression at the time which came as a result of the 1921/1923 crises and was accompanied by one of the most destructive hyperinflations known in the modern economic history. In order to resolve the reparation post First World War problem the Reparation Commission established a new committee on 16 September 1928 that comprised independent financial experts headed by Owen Young who created a new German reparation payment plan. The Young's committee produced on 7 June 1929 in Paris a report on its work along with the German reparation payment plan and a series of accompanying documents. At a conference held in The Hague on 20 January 1930 the interested countries' governments accepted Young's expert committee's report along with a new German reparation payment plan.[14]

Young's German reparation payment plan was based on commercialising the relation between the reparation debtors and creditors. German reparation debt was partially written off and the rest was split in 58 annuities of a new international loan which were payable in either a foreign convertible currency or Reichsmarks on the gold mark parity. Every reparation debt annuity was split in a fixed and a variable part. It was foreseen that Germany must keep paying the fixed part of the debt on a regular basis whilst in periods of extreme economic difficulties it was possible to delay paying off the variable annuity part. Further, the possibility of mobilising the fixed annuity part was foreseen too. That is trade in the fixed part of German reparation debt state bonds, conducted in the same way as any other trade in securities done on capital markets. Given that Joung's reparation plan laid down the exact amount of the reparation debt and its settlement deadline it was no longer necessary to measure the progress of German economy annually, and therefore the prosperity index was cancelled.

Young's plan foresaw the reparation debt deadline extension till 1988. According to the plan, in the period from 1929 to 1988 the Kingdom of Yugoslavia was to receive war damages of 3.9 billion Reichsmarks in total; up till 1966 it was envisaged that the country should be receiving 84 million Reichsmarks annually and then 22.7 million Reichsmarks per year successively until the final settlement of the debt. However, the grave financial and banking crisis that Germany was going through during the Great Depression caused all war reparation payments to be suspended in 1931. Thus, the Kingdom of Yugoslavia was deprived of its one annual income totalling 600 million dinnars in foreign exchange.

[14] The documents reffering to post World War I German reparation debt issue, signed in The Hague on January 30th 1930, are known in the International contracts corpus as "The Hague agreements". "The Hague agreements" were published in the Kingdom of Yugoslavia Official Gazette No. 124-XLVII, 1930.

3.4. External Debt Repayments to France in French Golden Francs

The Kingdom of Yugoslavia's foreign financial obligations soared in 1930, following the loan revalorisation that Serbia made in France between 1895 and 1913.[15] Contracts regarding loans stipulated that all loans should be paid off in French currency. Until 1930, war years included, the Kingdom of Serbia, and later the Kingdom of Yugoslavia dutifully met its contractual loan obligations and paid annually exactly the sums of money prescribed by the loan terms and conditions. However, as early as in 1924 French porters (Serbian state loan bond holders) started complaining against payments in paper French francs, requiring any further payments to be calculated exclusively in gold French francs. At the time when the loans were made the Gold standard was in power and it went without saying that there was by no means relevance as to whether the loans were being paid off in French francs – that is in banknotes that could be converted in gold, or in golden coins. After the world war the situation changed, the paper French franc had become legal tender, thus losing 80% of its pre-war golden value. Naturally the Kingdom did not hold itself liable for the French currency fall, which resulted in the issue of foreign loans made by the Kingdom of Serbia in France ending up before the Permanent International Court of Justice in The Hague.

The Court accepted the French porters' view and made a ruling on 12 July 1929 stipulating that the loans should be revalorised and further paid in gold. The Yugoslav government signed a Convention with French bond holders the following year of 1930, which stated that all the remaining debts should be revalorised. Under the Convention's provisions Yugoslav government was under obligation to start paying off of loans taken in France, starting from 1 April 1930, and to the gold French francs equivalent value. By means of this, the remaining part of the debt was five times multiplied as a post-war paper French franc was worth 0.20% of the pre-war golden currency. Admittedly, according to the amortisation plan, the government was not to start paying the debt off 100% in gold before 1 April 1958; in the meantime the debt was to be paid partially in gold and partially in paper French franc notes with the proviso that the golden share was to be gradually increased from 55% in 1930 to 100% in 1958. The year 1972 was

[15] The Kingdom of Serbia took five loans in France: Conversion (1895), Monopoly (1902), Railway and military armament (1906), Railway and the completion of military armament (1909) and a loan to cover Balkan Wars expenses (1913). D. Gnjatovic, *Stari drzavni dugovi, prilog ekonomskoj i politickoj istoriji Srbije i Jugoslavije 1862 – 1941 (Old State Debts, Contribution to Economic and Political History of Serbia and Yugoslavia),* Yugosslav Survey, Belgrade, 1991 (in Serbian).

set as a final deadline for the debt settlement and the paying off process was to be conducted in line with the amortisation plan.

Serbian pre-war loan revalorisation led to a disproportionate pressure on the state budget.[16] Whilst in the fiscal year 1929/30 it was necessary to allocate 895.4 million dinars for the purpose of paying off of foreign state loans, 1,016.9 million dinars were allocated in the following fiscal year of 1930/31, and 1,220.2 million in the fiscal 1931/32 year. We can only imagine what an enormous burden such increased state loan repayments imposed on the country's foreign exchange earnings, especially in the times when these earnings were falling precipitously. In the fiscal 1929/30 year, 7.7% of the country's foreign exchange earnings were spent on foreign loan repayments, the amount rose to 11% in 1930/31 and even to 19% in 1931/32. In the fiscal 1932/33 year, as much as 32.9% of the country's foreign exchange earnings were to be allocated to foreign debt repayments, as foreign debt annuities had raised to 1.277,2 million dinars whilst foreign exchange earnings slumped to merely 3.9 billion dinnars.

4. The Dinar Exchange Rate Stabilisation Measures

The Kingdom of Yugoslavia advocated a liberal foreign trade policy in between the wars. Such policy could not prevent other countries' foreign trade barriers' harming influences during the period of the Great Depression. Food exports were prohibited only during first post-war years, in which there was not enough domestically produced food to meet the local population's needs. Starting from as early as 1920, the government applied a series of restrictive foreign exchange measures by means of which it protected the domestic currency exclusively, exerting no influence whatsoever over either the structure or the direction of foreign trade.

4.1. Temporary Import Controls Concerning Certain Types of Goods between 1936 and 1938

Conditions under which international trade was conducted depended on bilateral trade agreement provisions. After the world war, all the trade agreements concluded between the Kingdom of Serbia and its later allied (and friendly) countries stayed in power and their validity was extended to the whole territory of the Kingdom of Yugoslavia. Some of these contracts

[16] Ministarstvo finansija, *Ministarstvo finansija 1918 – 1938,(Ministry of Finance 1918 – 1938),* Belgrade, 1939, p. 35 (in Serbian).

remained in power in the unchanged form even in between the wars, whilst some others were changed. The Kingdom of Yugoslavia concluded after the war new contracts with its former hostile countries and countries that were constituted from these (Czechoslovakia, Poland). The Kingdom of Yugoslavia's most significant trading partners were: Italy, Austria, Czechoslovakia, Germany, Greece and Hungary. Individual agreements were breached by the Yugoslav side during the Great Depression only in response to the agreements having been previously breached by the other signatories.

Yugoslavia was a country that did not impose restrictions on the importation of goods even for the duration of the Great Depression. Restrictive measures were introduced only in money transactions. The trade in goods, however, remained restriction-free up until 1936, at least regarding the countries that Yugoslavia had signed no bilateral goods related clearing agreements with. It was not before June 1936 that the government imposed certain import controls with a view to preventing unnecessary imports, that is, unnecessary spending of foreign exchange. A list was drawn up comprising products that were free to be imported only once a permit issued by the National Bank was secured. By means of this, importers were indirectly forced to first consider allowed options from the list regarding the importation of goods from the so called clearing countries. Partial goods importation control was abolished in 1938.

4.2. Temporary Suspension of Foreign Debt Repayments and Foreign Debt Rescheduling

Whilst foreign trade flows could be more or less protected by compensation arrangements, no solution was found during the crisis to protect international financial capital against an extreme decline. Debtor-countries, whose income was plummeting drastically, simply had no sources from which to pay off their debts. Latin American countries started on 1 January 1931 a series of foreign debt payment suspensions. From the region, only Argentina continued paying its external financial obligations during the crisis. In Europe, Germany suspended its foreign debt payments in 1924, and in 1931 it stopped reparation payments as well. It was followed by the winning countries that stopped paying their mutual inter-ally debts. Also, many countries called upon their creditors asking for a reduction in their debt burden. These decisions had devastating consequences on the world's financial capital. In the period from 1929 to 1935 international annuity payments dropped by two thirds, which was the same rate at which the world's trade value calculated in gold fell. Between 1929 and 1934, the United States and Great Britain, world's largest creditors, lost respectively 71% and 58% of their foreign long term investments income.[17] A number of governments rose against international financial capital that fought to its last breath for maintaining its rights to collect debts regardless of the debtors' weakened debt repayment possibilities.

Facing foreign exchange shortage in the time when foreign loan repayments obligations increased, Yugoslav government decided, in October 1932, to suspend temporarily all payments in foreign currency and launch negotiations with foreign creditors on reducing debt repayment burden. It should be stated that the decision on temporary debt payment suspension referred to foreign loans payable in foreign exchange only.

Under the Convention signed with foreign state loan bond holders in July 1933, Yugoslavia concluded a series of refinancing agreements regarding taking new loans in order to pay off the old ones. Under these agreements Yugoslavia was under obligation to pay off in foreign currency 10% of the annuity value that was payable within the prescribed three-year period, whilst 90% of it would be paid in new state bonds issued at 5% interest rate (the so called funding loan). Those bond holders who did not want 90% of the nominal value of their vouchers to be paid in new funding bonds had an option to be paid in dinars. By means of making this new state Funding loan Yugoslavia secured means to pay off its foreign financial obligations that were due from 14 October 1932 till October 13th 1935. Owing to this expensive financial operation, the country's foreign debt obligations payable in those three years were reduced from around 1.22 billion dinars to 120 million dinars.

Even when the deadline expired in October 1935 it was not possible for Yugoslavia to go back to earlier difficult conditions under which foreign loans had been paid. That is why funding bonds were re-issued in 1936, under a new Convention signed with bond holders. The Convention referred to a two-year period, from October 1935 till October 1937. It was agreed that 15% of the payable bonds' value was going to be paid in foreign exchange, whilst 45% would be paid through new funding bond issue. The remaining part of the debt was written off. The country's obligation to pay off its debts in foreign exchange was thus slightly increased whilst almost one third of all dues payable within three years was written off. The last Convention with state bond holders was signed in 1938, to pay 45% of debts due in a two year period, from October 1937 to October 1939, while the remaining part of those debts were written off.

---

[17] G. Brasic, op. cit., p. 42.

5. Concluding Remarks

Starting from 1938 the Kingdom of Yugoslavia began abolishing foreign trade and foreign exchange restrictive measures. It was an unquestionable sign of the restrictive measures conducted that far having yielded beneficial results. However, political turmoil preceding the Second World War forced the government and the National Bank once again to relinquish economic liberalism.

When the last Convention with bond holders was signed in 1938 the state terminated the expensive practice of funding bond issues, that is, the practice of incurring new debts in order to settle old ones. By this time foreign exchange earnings generated from exports of goods and services had improved somewhat, primarily thanks to an increase in exports of goods. Clearing agreements with Switzerland, Belgium and France were abandoned but clearing agreements with main trade partners still remained in power, such as with Italy, Austria and Germany. The structure of goods exported by Yugoslavia remained unchanged in the post-crisis years. Ten most important products participated in total export at the rate of 63.7% and 64.2% respectively in the years 1930 and 1938, and these products were wheat, corn, fruit, tobacco, pork, meat, eggs, cut timber, copper, and ores.[18] Just before outbreak of the Second World War, Germany had the most favourable position amongst the trading partners of Yugoslavia. The bilateral clearing agreement enabled Germany to obtain abundant interest-free crediting of imports from Yugoslavia.

Not once and not even during the times of the most severe crisis, the state did stop paying its internal loans or its foreign loan tranches payable in dinars. Owing to this, the Belgrade stock exchange did not stop working once, apart from the fact that between 1930 and 1933 state securities' prices were on the decrease. However, as early as in 1935/1936 the prices went up back to the pre-crisis level.

Owing to restrictive foreign exchange measures applied during the Great Depression, the dinar lost only 28.5% of its value against the Swiss franc, as established by its *de facto* and later *de iure* stabilisation. Over the years 1931 and 1932 the dinar exchange rate was falling against the Swiss franc only to get stabilised in January 1933. Since then and up till the end of the in-between war period the dinar was one of the most stable world currencies, its value standing at the Zurich money market unchanged at the rate of seven Swiss francs against 100 dinars. Restrictive fiscal policy undoubtedly contributed to the dinar stability in the period.

Facing a crisis, the government was forced to cope with a sudden drop of fiscal revenue. In only two years, from 1930/31 till 1932/ 33, government revenues

[18] O. Kovac. Op. cit., p. 324.

were reduced to their fourth. Three successive fiscal years (1931/32, 1932/33 and 1933/34) ended with rather small deficits; however, due to a rigorous restrictive fiscal policy the state finances weathered the period without any major turmoil. Once the crisis was overcome, government revenues started growing again, affording at the same time the growth of government expenditure, but still exclusively within the limits allowed by the growth of government revenues.

The money in circulation, which had been reduced by one fifth during the crisis, was now after the crisis standing again at the same level it was at in the time of the dinar's *de facto* stabilisation. However, just like in other European countries, on the eve of the outbreak of the Second World War, in Yugoslavia there was a sudden rise in inflationary tendencies and the quantity of money in circulation. Therefore, political climate once again became the cause of instability of the national currencies.

References

Aritonovic, R., Reparacije i Nemačka: Gde nas je rat ostavio?" (Reparations and Germany: Where did the War Leave Us?) Ekonomist, Belgrade, No. 1-2, 1928, pp. 33–56

Aritonovic, R., Reparacije i Nemačka: Dozov plan i njegova implementacija("Reparation and Germany: Dawes' Plan and its Implementation"), Ekonomist, Belgrade, No. 3-4, 1928, pp. 116–152

Brasic, G., Devizno-valutni propisi i njihov uticaj na spoljnu trgovinu, (ForeignExchange Regulations and Their Influence on Foreign Trade), Stamparija Drag. Gregoric, Belgrade, 1939

Dugalic, V., Mitrovic, A., Gnjatovic, D., National Bank 1884–2004, Belgrade, 2004

Gnjatovic, D., Stari drzavni dugovi, Prilog ekonomskoj i politickoj istoriji SrbijeJugoslavije 1864–1941 (Old State Debts, Contribution to Economic History of Serbia and Yugoslavia 1862–1941, Yugoslav Survey, Belgrade, 1991

Gnjatovic, D., Sto in en dan dinarske konvertibilnosti (101 Days of the DinarConvertibility), Prispevki za novejso zgodovino, Vol. XLVI, No. 2, 2006, pp. 27–40

Kindleberger, Ch. P., A Financial History of Western Europe, George Allen and Unwin, London, 1987

Kovac, O., Spoljnoekonomska ravnoteza i privredni rast, IV izdanje (External Balance and Economic Growth, IV edition), Savremena administracija, Belgrade, 1985

Ministarstvo finansija: Ministarstvo finansija 1918–1938 (Ministry of Finance 1918–1938), Belgrade, 1939 Ministarstvo finansija: *Zakon o odobrenju međunarodnog stabilizacionog zajma 7% od 1931. godine (Law on Granting International Stabilisation Loan of 7% from 1931)*, Belgrade, 1931

Nedeljkovic, M., Problem dugova u danasnjoj privredi, (The Issue of Debts in Today's Economy) *Privredni letopis Zaduzbine Nikole Spasica,* Belgrade, 1936

Nurkse, R. *International Currency Experience,* League of Nations, Geneva, 1944

Narodna banka, *Narodna banka 1884–1934, (National Bank 1884–1934),* Belgrade, 1934

Secerov, S., *Nase finansije1918 – 1925 (Our Finances 1918–1925),* Napredak, Belgrade, 1926

Topalovic, Z., The Dinar Issue, *Yugoslav Currency Reforms,* Napredak, Belgrade, 1930. pp. 8–24

Versajski Ugovor o miru, (Versailles Peace Treaty), *Sluzbene novine Kraljevine SHS*, no. 119a, 1920