Financial Reconstruction in Central and Eastern Europe after World War I: The Case of Hungary

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The First World War and the dismemberment of the Austro-Hungarian Monarchy had profound impacts on the further development of East Central Europe both economically and politically. In October 1918, the former self-sufficient economic unit broke into six different entities, which meant that the countries of the region had to adjust to the new circumstances. Post-war economic chaos was exacerbated by rampant inflation – except in Czechoslovakia – coupled with increasing budgetary problems caused by war expenditures. Additionally, the Kingdom of Serbs, Croats, Poland, and Romania had suffered very considerable war damages, which hindered their economic recovery. At the beginning of the 1920s, financial consolidation became an urgent task for all countries of the region, which coincided with the interests of the victorious Great Powers in the post-war years.

This paper seeks to evaluate the consequences of the reconstruction schemes in the countries of East Central Europe. Because of the low level of domestic accumulation, stabilisation could be carried out by the loans of the League of Nations. The only exception was Czechoslovakia, which was able to halt inflation and introduce stable currency in April 1919 without any external assistance.

As far as financial consolidation is concerned, the study also focuses on analysing the case of Hungary by introducing the main features of the stabilisation measures in the 1920s. The Hungarian stabilisation in 1924 also performed under the control of the League of Nations. The second part of the study presents the conditions of the loan extended by the League of Nations, analyses the elements of the stabilisation both in the budgetary and monetary sectors, as well as the features of the currency system established with English mediation.

Because of length constraints, the paper will not give an insight into the domestic politics of East Central Europe during the interwar period, rather it strives to represent the results of financial reconstruction in the region from macroeconomic perspective.

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[Financial Reconstruction; Economic Stabilisation; League of Nations, Central and Eastern Europe; Hungary]

Introduction

In the last three decades, the main focus of economic history research was to compare the Western and Eastern European countries in terms of their economic performance. Most of these studies analysed the development of certain sectors, such as agriculture, industry and trade by highlighting the strongholds and weaknesses of each country's national economy. Financial reorganisation, which played an exceptionally important role after World War I in East Central Europe, was not among the key objectives of research activities.

The reconstruction of the Central and Eastern European (CEEs) countries compared to Western Europe was a complicated task after the Great War, because virtually all the new states of the region had to face serious problems, inherited from the past and from the immediate post-war years. As Aldcroft and Morewood pointed out that the list of difficulties in Central and Eastern Europe was enormous: physical devastation and resource losses; territorial changes made by the dismemberment of the Dual Monarchy and the peace treaties. In economic terms, the countries of the region were hit by accelerating rate of inflation and currency instability, which coupled with balance of payments disequilibrium. Political instability was another main concern, which was accompanied by weak administrative systems. Finally, post-war territorial adjustments further complicated the political and economic unification of the component parts of the newly established states in the region. All these factors hindered the fast economic recovery in Central and Eastern Europe in the 1920s. At the same time, political conditions were quite unstable: ethnic conflicts and border disputes occurred between Czechoslovakia and Poland, which aggravated the economic problems of these countries.[1]

Considering of the precarious economic situation that the new states had to face immediately after the end of hostilities, the chief victorious Powers were interested in mitigating the supply crisis, which emerged because of the war. Therefore, between 1918 and 1923, appreciable

[1] D. H. ALDCROFT – S. MOREWOOD, Inflation, Reconstruction and Stabilization, in: D. H. ALDCROFT – S. MOREWOOD (eds.), *Economic Change in Eastern Europe since 1918*, Aldershot, Hants 1995, pp. 22–41.

quantities of relief supplies, mainly foodstuffs, were sent to Poland, Czechoslovakia, Serbia and other countries of the region. As Teichova noted that credits-financing of aid and deliveries during the period 1918–1923 came to 86.7% from the United States, 11.7% from Britain and 1.6% from Canada.[2] Despite these efforts, economic situation of the CEEs countries hardly improved and several countries, including Bulgaria and Hungary were compelled to pay reparations.

Berend and Ránki stressed that the victorious Entente Powers placed emphasis on the economic stabilisation of the countries in East Central Europe. After the consolidation of the Soviet system, they turned their attention to the states in the neighbourhood of the Soviet Union. They were afraid that Bolshevik regimes would spread to other countries and destabilise them politically. To avoid any possibility of potential revolution, they recognised the importance of economic consolidation in the region.[3]

In the mid-1920s, the League of Nations played an increasingly important role in the economic and financial stabilisation of the Central and Eastern European countries. The reconstruction schemes for Austria, Bulgaria and Hungary are remarkable examples of concerted international efforts to restore the economy and public finances to normalcy. The issue of international loans required reparations settlement and a comprehensive programme of financial consolidation. The programme of financial stabilisation encompassed the introduction of stable currencies, the creation of central banks with the issue of banknotes and the restoration of balanced budget.

The paper provides a theoretical background and a detailed analysis about the reconstruction schemes, which were carried out in the Central and Eastern European countries. For this purpose, its main aim is to evaluate the overall impacts of economic and financial stabilisation measures in each country of the region in the 1920s. As Nötel rightly noted that the elaboration and execution of these financial reconstruction schemes was no easy matter. First, conditions of financial stability had to be created in countries, which were hit severely by the strains and losses of World War I

[2] A. TEICHOVA, East-central and South-east Europe, 1919–1939, in: P. MATHIAS – S. POLLARD (eds.), *The Cambridge Economic History of Europe. The Industrial Economies: the Development of Economic and Social Policies*, Vol. VIII, Chapter XIII, Cambridge 1989, p. 927.

[3] I. T. BEREND – Gy. RÁNKI, *East Central Europe in the 19th and 20th Centuries*, Budapest 1977, p. 89.

and the accompanying economic problems, such as rampant inflation, cumulative budgetary deficits, deteriorating exchange rates and terms of trade. Second, creditworthiness had to be assured by introducing convertible currencies in the international money markets and manage the incurring debts.[4]

The paper is organised as follows. Section 1 tries to explain the reasons of international cooperation for the financial consolidation in Central and Eastern Europe in the post-war years. Section 2 introduces the reconstruction schemes in the Central and Eastern European countries based on relevant literature. Section 3 focuses on a case study by evaluating the main characteristics of the Hungarian stabilisation performed under the control of the League of Nations. The subsections are formed in the following order: 3.1 antecedents of the stabilization, 3.2 Loan from the League of Nations, 3.3 restoration of the budget equilibrium, 3.4 establishment of the National Bank of Hungary, and finally subsection 3.5. highlights the impacts of the reconstruction crisis, while it gives a brief overview of the credit expansion. Finally, concluding remarks are presented in Section 4.

Reconstructions Schemes: a Comparative Approach Austria

The first country of the region, which submitted a request for an international loan was Austria. According to the Treaty of Saint-Germain, signed between Austria and the Allied Powers in September 1919, the country was compelled to pay reparations, however, reparation charges had never been clearly defined. Although the burden of repairs was not considerable, but the main structural problems of the national economy, such as the loss of traditional markets, the scarcity of raw materials and agricultural products and difficult financial conditions remained during the interwar period.[5]

The first attempt to request for an international loan by Austria occurred in 1920, but efforts were wrecked. Due to strong inflationary pressures inherited from the war, the Great Powers in the League of Nations dispatched a Financial Committee to the country. As Teichova

[4] R. NÖTEL, International Credit and Finance, in: M. C. KASER – E. A. RADICE (eds.), *The Economic History of Eastern Europe 1919–1975. Interwar Policy. The War and Reconstruction*, Vol. II, Oxford 1986, p. 193.

[5] I. NÉMETH, Az első Osztrák Köztársaság (1918–1938): történeti áttekintés, in: I. NÉMETH – R. FIZIKER (ed.), *Ausztria a 20. században. Az „életképtelen" államtól a „Boldogok szigetéig"*, Budapest 2011, p. 131.

stressed the value of the Austrian gold crown equalled 14,000 paper crowns, the price level in Austria had risen 15,500 times and wages had on average increased 9,000 times in Autumn 1922.[6] Although inflation provided a stimulant to the economy, which was manifested by powerful investments, production and export boom from the late 1919 until the second half of 1922, but the balance of trade remained unfavourable, partly because of the limited supply capability of the economy initially and partly due to high import content of exports.[7] The new republic had continuous budgetary deficits between 1919 and 1922.[8]

Despite the strong opposition made by Social Democrats against the right-wing government led by Ignaz Seipel, the chancellor submitted a request for a reconstruction loan of 650 million gold crowns on 4 October 1922. According to the Geneva Protocol, Austria's sovereignty was guaranteed by the Great Powers in return for the renunciation of Anschluss with Germany.[9]

The Geneva Protocol consisted of three parts: the first guaranteed to respect Austria's economic and financial sovereignty and its integrity, the second granted a loan of the League of Nations under the supervision of Great Britain, France, Italy and Czechoslovakia, for the purpose of restoring budgetary equilibrium and repay loans taken from 1919 onwards. Protocol III contained the detailed implementation of the financial stabilisation.[10] The government undertook to introduce austerity measures by reducing public expenditures and increase tax revenues to achieve a balanced budget. The reconstruction scheme was controlled by the League's Financial Committee, headed by Alfred Zimmermann, who possessed a wide range of budgetary powers. According to Bachinger, the Geneva Protocol reflected the general economic and financial interests of foreign bankers and businessmen. Because all important decisions were taken by the Financial Committee, therefore, the fiscal manoeuvring room was narrow. As securities, Austria had to pledge their state property, their

6 TEICHOVA, p. 930.

7 D. H. ALDCROFT, Inflation, Currency Depreciation and Reconstruction in Europe, in: D. H. ALDCROFT (ed.), *Studies in the Interwar European Economy*, Aldershot, Hants 1997, pp. 65–66.

8 K. W. ROTSCHILD, *Austria's Economic Development between The Two Wars,* London 1947, pp. 19–23.

9 NÉMETH, p. 131.

10 I. T. BEREND – Gy. RÁNKI, *Közép- és Kelet-Európa gazdasági fejlődése a 19-20. században*, Budapest 1976, p. 307.

customs and match monopolies, and if necessary additional revenues. One of the most important objectives was to assure the creditworthiness of the economy.[11]

In compliance with the instructions of the League of Nations, the government stopped the issuance of unbacked banknotes and revalued the crown slightly between October and November 1922. In December, one gold crown was worth 14,500 paper crowns and it was stabilised at the same exchange rate. On 1 January 1925, the new gold schilling was put into circulation, which replaced the worthless paper crowns.[12]

The report, which was prepared by League's Financial Committee underlined the necessity to pursue a strict fiscal and monetary policy to restore budgetary equilibrium. Sustainable financial balance was achieved by credit control and increasing gold and foreign exchange reserves. The central bank's interest rate remained high to attract the inflow of foreign capital. As far as the reconstruction loan was concerned, financial reorganisation was successful because inflation was stopped and with the introduction of the schilling, economic life returned to normalcy. The restructuring of the finances ended officially in 1926, thus, Austria regained the control over its economic policy. Thanks to the strict implementation of the stabilisation programme, the budget was balanced and ended with a surplus over the period 1925–1929. At the same time, currency backing was increased from 54.6% to 78.6%, whereas interest rate was reduced from 15% to 7.5% by the central bank between 1924 and 1930, however, it still remained high compared to other European countries.[13] The reconstruction loan of the League of Nations became the model for the financial stabilisation schemes both to Hungary in 1924 and Bulgaria in the years 1926–1928.

Bulgaria

Bulgaria, similarly, to Austria and Hungary, also received foreign loans, which were essential to stabilise its currency. Inflation was less severe than in Austria and Hungary, but the Balkan country was compelled to pay 2.25 billion gold francs reparations according to the Treaty of Neuilly signed in November 1919. The latter was modified by a Protocol, adopted

11 K. BACHINGER, Österreich von 1918 bis zur Gegenwart, in: F. WOLFRAM – J. A. VAN HOUTTE – H. KELLENBENZ et al. (eds.), *Handbuch der Europäischen Wirtschafts- und Sozialgeschichte*, Bd. 6, Stuttgart 1987, p. 556.

12 BEREND – RÁNKI, *Közép- és Kelet-Európa*, p. 307.

13 BACHINGER, pp. 556–557.

on 21 March 1923, which substantially reduced these burdens to 550 million gold francs. As a result of the introduced reliefs, around 30 million gold francs were repaid, and 90% of reparations were fulfilled by goods deliveries up to 1928.[14]

In Bulgaria, all necessary steps were taken by the government to halt inflation. A decree was issued in the Summer of 1922, which maximized banknotes in circulation. From 1923 onwards the amount of money in circulation did not surpass that of 3–4 billion levs. In early 1923, the Bulgarian lev declined rapidly, therefore, authorities had to impose exchange controls. Parallel with these measures, a new foreign exchange rate was settled: 1 USD was made equal to 137 levs. Despite these efforts, both the wholesale prices and the cost of living increased almost 30 times compared to the pre-war level. Although monetary disaster was avoided by the introduction of austerity measures, the government's scope for budgetary action was reduced to minimum. Due to the deterioration of economic conditions, Bulgaria submitted a request for an international loan of the League of Nations in 1926 to carry out financial consolidation.[15]

Economic and financial stabilisation was implemented in two closely interrelated stages. As Nötel stressed the first Protocol was approved by the League's Council on 7–8 September 1926, the loan successfully issued on 21 September. The main objective of this agreement was to provide finance for refugee settlement but contained the elements of the reconstruction scheme. The second Protocol was adopted on 10 March 1928 and the loan issued eight months later, from 21 November to 3 December 1928. The latter arrangement brought further foreign finance for stabilisation, and it encompassed the creation of the central bank with the exclusive right to issue of banknotes. Bulgaria's Settlement Loan amounted to USD 16.2 million averaged at about 88.5% of the nominal total with an interest rate of about 7%. The 7.5% Stabilisation Loan, to an equivalent of USD 26.9 million was issued to-one half in the United States and to the other half in Switzerland, Belgium, and Italy. More than 52% of the reconstruction scheme was used to restore budgetary equilibrium. Another part was allocated to transport investment (25%), agricultural credit (13%) and finally, to emergency expenditure in earthquake-stricken regions (10%).[16]

14 BEREND – RÁNKI, *Közép- és Kelet-Európa*, pp. 271–272.
15 Ibid., pp. 309–310.
16 NÖTEL, pp. 197–199.

Financial reorganisation was completed in 1928, when Bulgaria switched to the gold-exchange standard. The lev was stabilised on 21 Sep-tember of the same year: one lev was being equivalent to 0.72 US cent or 1.92 gram of fine gold. As security for the loan issue, all sequestered revenues, including excise on salt and alcohol and the match monopoly, were released by the Reparations Commission. At the same time, foreign-exchange control was abolished six months after successful implementation of the stabilisation loan.[17]

Czechoslovakia

The only country of the region, which was able to stabilise its economic affairs immediately in the post-war years, was Czechoslovakia that can be explained by several factors. As Teichova rightly noted that compared to its neighbours, Czechoslovakia was not hit by the wave of inflation and avoided post-war confusion. Thanks to an early separation of the currencies accompanied by a currency reform, the Czech crown (Kč) remained stable during the interwar period.[18] After the end of the First World War, the relatively adequate supplies of essential foodstuffs and the absence of war devastation in the country contributed to the economic reconstruction. Political stability and the fact that Czechoslovakia inherited 70 percent of industrial capacities of the Dual Monarchy also played an important role in the fast recovery. As a result of stringent exchange controls and protective tariffs, favourable trade balances had been reached since 1920, whereas the value of the Kč on foreign exchanges was raised artificially by open market operations of the Minister of Finance, Dr. Alois Rašín. This resulted the relative overvaluation of the Czechoslovak currency, which erased the price advantages of Czechoslovak exports. Although deflationary policy had negative impacts on output and employment, but the adverse effects were offset by the flight from the German mark into safer currencies and the French occupation of the Ruhr in 1922, which brough new orders to Czechoslovak industries despite the rigours imposed on exports by the overvalued Kč.[19] All these factors promoted that inflation was held in check, the budget was balanced, and currency stabilisation was carried out at the end of 1922 a rate, which provided a fair basis for the Czechoslovak export trade. Czechoslovakia was able

17 Ibid., p. 199.
18 A. TEICHOVA, *The Czechoslovak Economy, 1918–1980*, London, New York 1988, p. 22.
19 TEICHOVA, East-central and South-east Europe, p. 930.

to find new markets for their manufactured goods in the 1920s.[20] The National Bank of Czechoslovakia also contributed to the financial reorganisation of the country with the accumulation of adequate gold and foreign exchange reserves and by the pursuance of credible monetary policy.

Romania

Although Romania belonged to the victorious Entente Powers during World War I and was enlarged by the addition of Transylvania and Partium from Hungary, had to face severe inflation due to the economic losses caused by temporary occupation of the country between 1916 and 1918. The territory and population of the post-war Kingdom of Romania trebled which coupled with increasing public expenditures. Therefore, the government issued unsecured banknotes to cover rising public spending. Additionally, the former crown used as a legal tender in the Austro-Hungarian Monarchy, had to be exchanged. As a result, the quantity of money in circulation rose significantly, whereas the value of the leu declined sharply up to 1922. However, depreciation of the national currency slowed down thanks to the British-American loan of £37 million, but the leu further weakened: one Swiss franc was equivalent to 44.5 leu. In the Summer of 1922, a complete moratorium on all transfers of money was ordered by the government and foreign liabilities were seized. The first stage of the stabilisation was carried out from 1922 to 1926, when an agreement was reached between the National Bank of Romania and the Ministry of Finance to stop securing expenditures with the issue of paper money. A liquidity fund was set up to settle all remaining liabilities of the state. Berend and Ránki stressed that inflation culminated in 1924, when the value of the leu declined to 2% of the pre-war level. From May 1925, the depreciation of the national currency ceased, and the value of the leu increased slightly, however, fluctuation of the exchange rate continued because one Swiss franc was worth 50 leu.[21]

The second stage of financial reconstruction was accomplished on 7 February 1929, with the aid of a long-term government loan of USD 101 million and a rediscount credit of USD 25 million granted to the National Bank of Romania by thirteen cooperating central banks. The

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20 E. A. RADICE, General Characteristics of the Region, in: M. C. KASER – E. A. RADICE (eds.), *The Economic History of Eastern Europe 1919–1975. Economic Structure and Performance between the two Wars*, Vol. I, Oxford 1985, p. 42.

21 BEREND – RÁNKI, *Közép- és Kelet-Európa*, pp. 311–312.

7% Stabilisation and Development Loan was constituted as a direct obligation of the Autonomous Monopolies Institute, and it was unconditionally guaranteed by the Romanian state. In return, all monopoly revenues were mortgaging except for those of the match monopoly, which were guaranteeing the portion of the loan granted by the Swedish Match Corporation. As Nötel emphasized of the total receipts of estimated USD 85 million, USD 25 million were used to improve the liquidity of the National Bank by taking over one part of its portfolio; USD 20 million served for repaying short-term debts and restore budgetary equilibrium and USD 35 million were used for railway investment. The remaining was applied to other investments.[22]

The legal parity of the leu was fixed by the currency law, adopted on 7 February 1929, which was tied to gold. In terms of the law, 1 USD was worth 167 leu and 1 leu was made equal to 10 milligrams of gold of nine-tenths pure content. The modified status of the National Bank of Romania, approved on 3 March 1929 stipulated to maintain a minimum reserve of 35% of its note issue and other liabilities in gold or foreign exchange of gold-standard countries.[23]

Poland

In Poland, the road to economic and financial stability was to be long and difficult. Reconstruction was retarded by the massive physical destruction and devastation on Polish territory caused by World War I. As a result of war operations, both the industrial plants and the agriculture suffered from serious losses. Because external frontiers with the USSR (the Polish-Soviet War ended in 1921) and with Germany (the final agreement on the division of industrialised Upper Silesia was signed in 1922) were not settled, therefore, economic chaos emerged in the country. Morewood highlighted the problems, which arose from the unification of three different segments, formerly belonged to Germany, Russia, and Austria-Hungary.[24] The new republic experienced large budgetary deficits that could only be covered by the issue of unsecured banknotes because governments recognised this as a useful tool in the reconstruction process.[25]

Berend and Ránki rightly noted that hyperinflation paralyzed the

22 NÖTEL, p. 207.

23 Ibid.

24 ALDCROFT, Inflation, Currency Depreciation and Reconstruction in Europe, p. 69.

25 W. ROSZKOWSKI, The Growth of the State in the Polish Economy in the Years 1918–1926, in: *Journal of European Economic History*, 18, 1, 1989, pp. 105–126.

entire economic life in Poland over the period from 1918 to 1924. The currency in circulation rose from 150,000 million Polish marks to 570,698 million marks between November 1918 and April 1924. By the Spring of 1924, the value of the Polish mark sank to virtually zero: 9.3 million marks were equal to one dollar.[26] To stop the process of depreciation, a series of reforms were introduced by the right-wing government of Władislaw Grabski. The measures included the introduction of a new currency, the złoty, which replaced the worthless Polish mark and the creation of the Bank of Poland. Budgetary equilibrium was achieved by reduction in state expenditures and increased and more efficient collection of taxes.[27] Moreover, economic stability had to be restored by the sales of some public-owned industrial and commercial enterprises. As a part of the austerity measures, railway tariff rates were raised, and the number of public employees and state authorities was reduced.[28]

Despite the efforts of the government, the economic situation of the country hardly improved. Because the parliamentary regime was too weak, fiscal measures could not be implemented successfully. According to Aldcroft and Morewood several other factors contributed to the renewed weakness of the currency, including a deterioration in the trade balance, poor harvests, a tariff war with Germany in 1925 and the absence of external aid, which could have bolstered confidence.[29] Therefore, the first attempt to stabilise the Polish economy failed, and the exchange rate of the zloty further weakened and reached its nadir in May 1925. Teichova stressed that when the Polish government got into renewed difficulties during her second inflation it was Montagu Norman, the Governor of the Bank of England, who refused to grant an international loan to Poland. Thanks to the support of the Governor of the Bank of France, Emile Moreau, and the Governor of the Federal Reserve Bank of the USA, Benjamin Strong, an international consortium of banks extended a stabilisation loan of USD 62 million to Poland in 1927. Charles Dewey was dispatched to Warsaw to supervise the fulfilment of the loan's strict conditions for three years.[30] The 7% Stabilisation Loan contained a series of measures for the preservation of budgetary balance. It included a substantial increase

26 BEREND – RÁNKI, *East Central Europe in the 19th and 20th Centuries*, pp. 88–89.
27 P. D. STACHURA, *Poland 1918–1945. An Interpretative Documentary History of the Second Republic*, London 2004, p. 50.
28 K. SZOKOLAY, *Lengyelország története*, Budapest 2006, p. 162.
29 ALDCROFT – MOREWOOD, p. 40.
30 TEICHOVA, *East-central and South-east Europe, 1919–1939*, pp. 932–933.

in budgetary revenues accompanied with the reduction of administrative expenditures. Budgetary equilibrium was to be safeguarded through a special reserve, which was constituted from one part of the loan receipts. The government undertook not to contract foreign or domestic loans for three years for budgetary purposes.[31]

The general strike in Britain in 1926 gave a considerable boost to Polish coal exports, which improved Poland's foreign trade balance, and this enabled the zloty to be stabilised in October 1927.[32] The new parity rate of the zloty was fixed at 11.22 US cents, instead of the former 19.30 US cents, which meant a devaluation to 58% of the original parity rate.[33] With the help of the reconstruction loan, confidence was restored in the currency and exchange rate fluctuations ceased too.

Yugoslavia

Post-war reconstruction of Yugoslavia was the most difficult task of any of the countries of the region. As Radice stressed some regions had suffered from very considerable war damage, including the territory of Serbia, which became a battlefield during World War I. Therefore, both the transportation infrastructure and the industrial plants were devastated, and livestock was also decimated. The unification of different fiscal and administrative systems hindered the fast economic recovery. Budgetary problems arose from the fact that Serbian fiscal methods were applied in the whole country.[34] The successor states used the common currency of the former Dual Monarchy, the crown, whose value declined sharply. Between January and December 1919, the old banknotes were overprinted to stop the issue of unsecured money. Finally, they were withdrawn completely from circulation. As a result of financial stabilisation, carried out in January 1920, the Yugoslav dinar replaced the four different currencies that were worthless. The withdrawal of money in circulation and the loans granted to the state led to the increase of the volume of the new currency, which amounted to 2.7 billion dinars. State assets, including mines and forests as a guarantee of the government were assigned to the National Bank of Yugoslavia to preserve liquidity.[35]

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31 NÖTEL, p. 205.
32 RADICE, p. 43.
33 NÖTEL, p. 206.
34 RADICE, p. 44.
35 V. RAB, *Diagnózisok és terápiák. Javaslatok az európai gazdaság újjáélesztésére az első világháború után*, Budapest 2010, p. 99.

Increasing state expenditures, which served direct military aims could not be covered by normal tax revenues and customs receipts and the profits of state-owned enterprises. Therefore, budgetary deficits were financed by issuing of unbacked banknotes. This led to the depreciation of the dinar. Foreign liabilities comprised the bulk of the burdens that reached 30 billion dinars. A major part of these burdens, 15.3 billion dinars originated from the war debt of the Kingdom of Serbia. The pre-war loans and debts contracted by the former Austro-Hungarian Monarchy amounted to about 2.2 and 1.4 billion dinars.[36]

According to Radice, at first there was a strong desire by Yugoslavia to stand on its own feet and was particularly suspicious in the early years on foreign capital, which in the Yugoslav mind, was associated with the dominance of Vienna and Budapest.[37] Legal stabilisation of the Yugoslav dinar was accomplished in the Summer of 1931. At the same time, a new currency law was adopted on 11 May 1931 and the revised status of the National Bank of Yugoslavia was also approved. The 7% Stabilisation Loan of 1,025 francs or USD 40 million were guaranteed by French, Swiss, Czechoslovak, Swedish and Dutch banks. The bulk of the international credit (USD 33 million) were paid to the National Bank of Yugoslavia as reimbursement for "past advances to the State", and the remaining part were used for the purposes of economic consolidation. The legal parity of the dinar was fixed at 26.5 milligrams of pure gold. 1 Yugoslav dinar was made equal to 1.7612 cent, and 1 dollar was worth 56.78 dinars.[38] In the 1920s, financial reorganisation in Yugoslavia was accompanied by the introduction of a convertible currency, which was tied to the gold standard.

The Case of Hungary

Antecedents

After the First World War not only with the effect of the Treaty of Trianon covering every economic and social dimension but the total isolation of the country had to be considered in Hungary. In addition to the huge loss of territory and population the production, logistic and market networks

[36] H. SUNDHAUSSEN, Jugoslawien von 1914 bis zur Gegenwart, in: F. WOLFRAM – J. A. VAN HOUTTE – H. KELLENBENZ et al. (eds.), *Handbuch der Europäischen Wirtschafts- und Sozialgeschichte*, Bd. 6, Stuttgart 1987, p. 910.

[37] RADICE, p. 44.

[38] NÖTEL, p. 210.

organically established within the framework of the Austro-Hungarian Monarchy were also thrown into disorder. Until the Treaty of Trianon the country operated within one regional economic integration, a 50 million market and within its part of a one currency zone. Starting from the 1920s Hungary was highly dependent on joining the international division of labour and the changes of the international prosperity.[39]

Having addressed the realities, the starting point of the consolidation strategy of the Bethlen government was joining the international political and economic life. Temporary adjustment to the circumstances established by the Treaty of Trianon, the acceptance of the status quo was the first step in the direction of the normalisation of the situation, consolidation. Already in his national assembly speech held on 19 April 1921, while speaking about foreign affairs, Count István Bethlen emphasised the necessity of integration into the forced situation established by the Treaty of Trianon. Hungary requested it accession to the League of Nations on 22 August 1922 and on 18 September 1922 it was granted by a unanimous verdict. Although after the wartime period the inflation policy played a large role in moving the Hungarian national economy from the rock-bottom, it was clear to everyone that it could not continue indefinitely. Between 1914 and 1924 the prices grew 8 thousand times while the wages "only" 3.5 thousand times. The value of money decreased continuously, the public budget showed huge deficit year by year. The depreciation of the korona (crown) almost completely destroyed that small capital, which was left after the series of disasters. All this resulted in a poverty of a degree, which could have easily led to another political destabilisation.[40]

After the conclusion of peace several attempts were made to regularise the economic situation and stabilise money. The first attempt for stabilisation based on internal resources was made by Lóránt Hegedüs, Minister of Finance, in 1921. The idea was to link korona to the French franc and it expected the drastic reduction of expenses and increase of incomes, primarily from the newly levied assets taxes. In addition to this deflation measures were also taken. The improving rate of the korona, however, made exports significantly more expensive deteriorating thus the export opportunities considerably. The attempt was also highly disapproved by

39 J. HONVÁRI, A gazdaság a két világháború között, in: J. HONVÁRI (ed.), *Magyarország gazdaságtörténete a honfoglalástól a 20. század közepéig*, Budapest 2003, pp. 320–321.

40 Z. KAPOSI, *Gazdaságtörténet*, Pécs 1997, pp. 190–191.

the Hungarian reigning élite due to the costs they were made to pay in the interest of the financial stabilisation. The stabilisation attempt built exclusively on internal resources collapsed by the autumn of 1921. To avoid control by the League of Nations – after the fall of Hegedüs – the Bethlen Government attempted to take out foreign private loans. The influential centres of the international capital market were monitored steadily in the attempt of looking for an opportunity to obtain a larger loan. Despite the efforts it became clear by 1922 that the direct interest undertaking of the New York money market was not an option for us. The Hungarian orientation for taking out a loan finally turned to England. The role of the English political and financial circles was influential all throughout the negotiations concerning the preparatory works for the stabilisation and the loan. England, however, also insisted that the country had to turn to the League of Nations. Under this condition England did promise every support.[41] The unsettled reparation and the fact that the main income sources of the state had been seized as security for the war reparation make it more and more obvious that the country could not expect a long term foreign private loan.

Despite every effort and the promise of Bethlen, according to which we would not give up our sovereignty, we were forced to take the loan offered by the League of Nations resulting in constant control and supervision from part of the winning states. On 6 November 1923 the delegates of the League of Nations and the Reparations Commission arrived at Budapest to survey the general economic condition of the country and give a recommendation about the amount of the loan, the period of restructuring and the measures of stabilisation. The foreign experts came to the opinion that Hungary required a loan of 200–250 million gold koronas, from which the reconstruction could be implemented in 2–2.5 years. The Hungarian standpoint requested a loan of 400 million gold koronas and a 3-year stabilisation period.[42]

The central element of the whole financial settlement was ensuring monetary stability. This goal was wished to be achieved via three cardinal principles. The first was to establish the balance of the state budget at all costs to avoid the state resorting to the mint to cover its expenses resulting in depreciation. The second principle was the establishment of

41 Gy. PÉTERI, Montagu Norman és a magyar szanálási mű. Az 1924-es magyar pénzügyi stabilizációról, in: *Századok*, 1, 1985, pp. 138–140.

42 M. ORMOS, *Az 1924. évi magyar államkölcsön megszerzése*, Budapest 1964.

a central bank operating according to strict rules and the third one was the return to strict coverage principle in money supply.[43]

After the negotiations the Reparations Commission approved the suspension of the reparation security right, by which the granting of the loan by the League of Nations was given a freeway.

Loan from the League of Nations

The scheme of the financial reconstruction and Protocols I and II additional to it were signed in March 1924, which the Hungarian legislation enacted in April 1924. The establishment of a central bank independent of the government was also enacted together with the conventions and contracts concluded with the different states during the negotiations related to the reconstruction.

Protocol I was of political character, in which the states signing it (England, France, Italy, Czechoslovakia, the Kingdom of Serbs, Croats, Slovenes and Romania) guaranteed to respect the sovereignty and territorial integrity of Hungary and Hungary guaranteed the loyal implementation of the peace-treaty. Protocol II incorporated the detailed scheme of the reconstruction also establishing the sphere of activities of the high commissioner delegated to its control and management if necessary. The Council of the League of Nations sent Jeremiah Smith,[44] financial expert from Boston, the confidant of John Pierpont Morgan to Hungary. Smith began his work on 1 May 1924.[45]

The above-mentioned laws vested full powers in the Hungarian government in order to allow it to take every necessary action for the success of the reconstruction. In these terms the only duty of the government was to previously present the decrees to be issued to a parliamentary committee, which could, however, not prevent the issue of the decrees.

More than half of the League of Nations loans was taken over by the English money market and a further six countries, among them USA,

43 E. DOMONKOS, A gazdasági és pénzügyi stabilizáció eredményei Kelet-Közép-Európában a két világháború közötti időszakban, in: S. CSILLAG (ed.), *Alkalmazott Tudományok Fóruma*, 3, 2016, p. 195.

44 Jeremiah Smith financial lawyer and legal counsellor joined the work of the peace conference after the war as a financial expert. He participated in the negotiations related to the Austrian and Bulgarian peace-treaties and worked in Japan, China and Mexico in preparations and management of international loan transactions.

45 Z. PETERECZ, *Jeremiah Smith és a magyar népszövetségi kölcsön, 1924–1926. Egy jenki pénzügyi ellenőr története a Magyar Királyságban*, Debrecen 2018.

Switzerland, and Italy, participated in the subscription of the rest. The loan was issued on extraordinarily adverse conditions. The creditors took over the loan at issue rates between 80–88%, therefore the 7.5% interest accounted for 9.0589155% converted to net profit. As security of the loan the creditors pledged the incomes of the sugar tax, the tobacco, and the salt excise. The loan was subordinated to any other state debt.[46]

Table 1. State Loan of the Kingdom of Hungary, 1924

Issuing county	**Inte-rest**	**Loan face value**			**Rate**	**Rate for sales**		
		Original currency	Gold korona	Pengő		Original currency	Gold korona	Pengő
Great-Britain	7.5%	7,902,700 £	168,722,645	195,465,184	84%	6,638,268£	141,727,022	164,190,755
USA	7.5%	9,000,000 $	44,414,986	51,454,761	80%	7,200,000$	35,531,989	41,163,809
Italy	8.5%	170,000,000 Líra	36,228,046	41,970,191	88%	149,600,000 Líra	31,880,680	36,933,768
Switzerland	7.5%	30,000,000 sv. Fr.	26,196,364	30,348,488	85%	25,500,000 sv. Fr.	22,266,909	25,796,214
Sweden	7.5%	4,585,000 sv. K	5,994,482	6,944,607	84%	3,851,400 sv. K	4,195,365	4,860,330
Netherlands	7.5%	5,000,000 Hol. Ft.	9,257,466	10,724,774	84%	4,200,000 Hol. Ft	7,776,271	9,008,810
Czecho-slovakia	7.5%	83,620,000 cs.K.	12,144,840	14,069,797	84.75%	70,867,950 cs.K.	10,292,752	11,924,153
Hungary	7.5%	850,000 $	4,194,752	4,859,620	86%	731,000 $	3,607,485	4,179,271
Altogether			**307,153,581**	**355,837,422**			**257,278,473**	**298,057,110**
Issuing costs							5,100,965	5,909,468
Amounts received							**252,177,508**	292,147,642

Source: State Loan of the Kingdom of Hungary, 1924. Reports on Hungarian State Loan 1924–1944. Ministry of Finance, General documents. National Archives of Hungary. General Archives (MNL OL), K 269, parcel 543, item 340.

The net profit of the League of Nations loan amounted to 257.2 million gold koronas at the rates of 26 June 1924, of which the portion exceeding 252 million gold koronas was imputed to the issue costs. Pursuant to the

[46] Gy. DOMÁNY, *A magyar szanálás*, Budapest 1927.

conditions of the League of Nations loan every partial issue of the loan must have been repaid until 1 February 1944.

The utilisation of the loan was controlled by Smith high commissioner. He, furthermore, controlled the Hungarian budget and vetoed every expenditure, which would have endangered the implementation of the scheme. If he judged so, he even had the right to levy new taxes. He made sure that the state incomes pledged as security were paid to a separate account, from which payments could only be made with his approval. According to its specified goal the loan could only be utilised to finance the budgetary deficit.

Restoration of the Budget Equilibrium

János Bud, Minister of Finance, submitted the restoration budget in December 1924, which strictly followed the budgets established by the Financial Committee of the League of Nations.[47]

Act IV of 1924 on reconstruction was titled "Restoring the balance of the state budget" and its measures also emphasised the same. A separate chapter was devoted to the reduction of the costs, the backbone of which was the issue of clerks and civil servants. It, however, also took care of reforming certain areas of the administration, moreover, it demanded the simplification of the administration and judicial proceedings. A serious reduction of the expenditure was the reduction of the headcount of state employees and the restriction of the emolument of pensioners. Pursuant to the reconstruction scheme the headcount of state employees (including the employees of state-owned factories) had to be reduced by 15,000 persons by the end of June 1926. Their headcount was 198,874 persons according to the budget of 1923/24.[48] As opposed to this, according to the budget of 1926/27, this headcount was 160,548, meaning that the headcount of persons in state employment was reduced by 38,326, more than twice the number of the prescribed 15,000 persons.

The establishment of the National Saving Commission (Országos Takarékossági Bizottság) served the overall implementation of simplifying the administration and the enforcement of austerity. The Commission

[47] Speech of János Bud (Minister of Finance) in meeting 353 of the National Assembly, December 12, 1924. *Diary of the National Assembly*, Vol. XXIV, December 12, 1924 – January 29, 1925, pp. 1–5.

[48] Between 1913 and 1939 the budget year began on 1 July.

put great emphasis on making the administration more efficient and on elaborating its disciplinary-accountability system. It reviewed every area of the state bureaucracy and achieved significant results in cost reduction. It aspired to eliminate parallelism and actively contributed to raising awareness in the Hungarian state life and administration of concepts such as economy or profitability.[49] As a result of the saving measures the ministry of food was closed, the in-kind supply provided to public servant employees at discount price stopped, the price review committees and the coal government committee ceased. Part of the state offices and institutions was merged, and the procedures were also simplified. Starting from July 1924 monthly budgets and profit and loss accounts were prepared for the continuous control of the state budget, which were published in the reports of the League of Nations high commissioner.

The next chapter incorporated the increase of incomes intended to be achieved by increasing the tax rates and tax bases. The primary task of the reconstruction policy was the restoration of the almost completely destroyed tax morality. To achieve this a well-functioning financial administration had to be established, in the interest of which tax administration was transformed into first degree tax authorities bringing financial administration closer to the society. Strict measures were taken, which were embodied primarily in rather high default interests and other fines. In the case of certain taxes, especially in the case of sales taxes, special rewards and shares were allocated to the revealers of hidden tax bases.[50] Income tax was defined progressively, the tax rate of which varied between 1% and 40% and also took the number of persons dependent on the income into account. The lowest item of the assets tax was 0.1% for 4000 gold koronas tax base and its highest item amounted to 1% for 16 million gold koronas tax base.[51]

49 E. BARACSI, Országos Takarékossági Bizottság (1925–1931). A magyarországi racionalizálási mozgalom megindulása, in: *Levéltári Szemle*, 3, 1980, pp. 305–327.

50 *Memorandum of the Hungarian Government to the League of Nations in the Subject of the Financial and Economic Situation of Hungary and the Supply of Civil Servants.* MNL OL, Collection of Documents regarding the Reconstruction of Hungary 1923–1926, K 26, 1387 parcel, folder d.

51 DOMÁNY, p. 42.

Table 2. Appropriations and Revenues in the Budgetary Years of 1924/25 *(million gold korona)*

Type of tax	Revenue Appropriation	Revenue
Direct taxes*	94.60	93.10
Sales taxes	80.00	157.80
Dues	30.03	59.90
Consumption tax	31.00	57.80
Custom duty	23.50	104.80
Salt excise duty	14.60	16.80
Tobacco excised duty	51.00	89.20

* Direct taxes: Land tax, Income- and wealth tax, corporate tax.

Source: Domány, p. 73.

As it is seen from the table, the indirect taxes levied on the wide consumer strata, incomes from the sales taxes and excises increased most compared to the plan. The quadruplication of the customs revenues was the result of the new customs system including tariffs significantly higher than before coming into force on 1 January 1925.[52]

As a result of the measures the structure of the tax incomes also changed. In the income structure the percentage of the direct taxes, duties and revenues increased at the expense of sa;les taxes. Decrease was only experienced in the customs incomes from 1926/27 because of the concluded commercial treaties. The increase in the direct tax incomes was mostly the result of the reforms and tightening in the execution system and the increase of the income from the other tax types was undoubtedly due to the improving economic situation and the growing purchasing power of the population.

The strict implementation of the reconstruction yielded a result within a very short time. In 1923/24 it was still really necessary to use part of the loans to cover the deficit, however the 1924/25 budget not only was not closed with a deficit but resulted in 90.3 million gold koronas income surplus.[53]

[52] HONVÁRI, p. 345.

[53] Pursuant to the reconstruction scheme the 1924/25 budget was based on gold korona, however, as the effective tender was paper korona, the establishment of the relation only caused unnecessary difficulties. For this reason, the 1925/26 budget was already drawn up in paper korona and the 1926/27 estimates had to be made on "pengő" basis as in the budgetary year (from 1 January 1927) this new legal tender was introduced.

Table 3. Percentage Share of Tax Revenues over the Budgetary Years

	1923/24	1924/25	1925/26	1926/27
Direct taxes	15.90	16.20	21.20	24.90
Sales taxes	40.80	27.50	18.50	18.90
Dues	5.90	10.80	13.70	11.70
Consumption tax	11.00	10.10	11.40	10.30
Custom duty	9.40	17.70	16.20	10.60
Salt excise duty	2.00	2.10	2.40	2.20
Tobacco excised duty	15.00	15.60	16.60	21.40

Source: Annual Tax Revenues 1923–1927. Ministry of Finance, General Documents, National Archives of Hungary. General Archives, (MNL OL) K 269, parcel 518, item 1, parcel 515, item 1.

As it was clear that the achieved result was not a one-off, the minister of finance was prompted to rethink certain elements of the economic policy. One such pursuit was the launch of tax reforms aimed at the reduction of the tax burdens and another one was the launch of resolute investment schemes.[54]

Having examined the budgetary balance of the different years it is seen that from 1924/25 every year ended with a surplus.[55] As starting from 1924/25 there was no deficit in the state budget at all, the remaining portion of the loan gave an opportunity to finance investments contributing to the strengthening of the financial and economic situation of Hungary.[56] A mere 70 million gold koronas from the loan were used to finance the deficit and from the remaining amounts - upon the approval of the Council of the League of Nations – 50 million gold koronas were used in 1925/26 and a further 50 million gold koronas in 1926/27 to perform investments and the remaining amounts were utilised in the following two years of 1927/28 and 1928/29.[57] The loans mainly served

54 B. KENÉZ – I. TEMESVÁRY, *A nemzetgyűlés pénzügyi bizottságának jelentése az 1925/1926. évi állami költségvetésről*, in: *Nemzetgyűlési Irományok*, No. 963, Budapest 1925.

55 While the state budget was significantly growing in the given years.

56 S. HAJDRIK, Államháztartásunk a szanálás óta, in: *Közgazdasági Szemle*, 1, 1933, pp. 632–682.

57 *Memorandum of the Hungarian Government to the League of Nations in the Subject of the Utilisation of the State Loan and the Investments.* MNL OL, Collection of Documents regarding the Reconstruction of Hungary 1923–1926. K 26, 1387 parcel, folder h.

the reconstruction of the public utilities and were also channelled into agriculture.

Establishment of the National Bank of Hungary

The establishment of the National Bank was also supervised by the Financial Committee of the League of Nations, which specified rules and took actions. To control the monetary policy Royal Tyler arrived at Hungary.[58]

"Act V of 1924 on the founding and patent of the National Bank of Hungary" was based on the agreements with the League of Nations. The articles of association stipulated that the central bank was not allowed to extend loans to the government.

The articles of association obliged the central bank to introduce a currency on gold basis. When the proportion of the bullion reserve was prescribed the so-called "one third security" system, which became a dogma by then, served as a starting point. The "Gold Committee" of the League of Nations, however, became slightly more lenient stating that "*lower percentage of security could also serve its purpose*".[59]

The National Bank of Hungary commenced its operation on 24 July 1924. Pursuant to the contract[60] concluded by and between Sándor Popovics[61] and Montagu Norman, the governor of the Bank of England, korona was stabilised by taking pound sterling linked to gold as basis. One English pound equalled 346,000 koronas and one gold korona equalled 17,000 paper koronas. By this korona was indirectly linked to gold via the English pound. Due to the problem of the overpriced English pound, however, Hungary already dismissed the pound base in the following year, in 1925. By the cessation of the underlying English guarantee the monetary system returned to the direct gold base, which also meant that the country could implement its commitments from its own resources.

58 Royal Tyler had previously been the director of an English bank in Paris. He received his first serious assignment in the American peace delegation, after which he became member of the Reparations Commission. He was delegated to Hungary in 1924 to the side of Jeremiah Smith and he remained in Hungary even after Smith finished his job. Later he returned to England and came back to Budapest in 1931 as the financial high commissioner of the League of Nations.

59 *National Body of Laws*, Act V of 1924, April 26, 1924, p. 18.

60 For the English and Hungarian background of the stabilisation please refer to Gy. PÉTERI, Montagu Norman and the Hungarian "Reconstruction Work". About the Hungarian Financial Stabilisation of 1924, in: *Századok*, 1, 1985, pp 121–151.

61 Chairman of the National Bank of Hungary from 1924.

After the beginning of the financial reconstruction trust in the Hungarian economy and finances grew both domestically and abroad. It resulted in being able to increase the bullion reserve from 20% prescribed for the first five years to 54.5% on 21 December 1924 already. This then caused a serious conflict between the chairman of the central bank and the minister of finance. The minister of finance regarded the 400 million gold koronas banknote quantity insufficient compared to the payment and credit turnover of the country. And the central bank noticeably made a point of honour of the large security.[62]

One serious consequence of the interest of the League of Nations loan, which was high in the circumstances of that time, was the increase of the Hungarian interest rate level and the growth in the price of further foreign loans. The amount of the banknote turnover of the country, which was prescribed rather tightly, was also specified by the experts of the League of Nations. For deflation monetary policy considerations, the National Bank of Hungary also cooperated in this action. The high interest rate level almost sucked the economy dry. In autumn 1924 the interest rate was 12%, which the supreme council of the National Bank of Hungary reduced to 11% in March 1925, to 9% in another two months and to 7% at the end of October, which then remained unchanged until the end of the reconstruction.[63] Due to the shortage of cash the otherwise viable companies also became disabled. They would have needed start-up funds. As it was said at that time only the “ignition energy” was missing.

While the central bank followed a deflation monetary policy, Jánus Bud, Minister of Finance, continuously urged the widening of the banknote quota. Every economic sector experienced the lack of credit limits. As the main drawback of the rigid policy of the central bank Bud called attention to the fact that the high interest rates completely disabled the agriculture and forced the major industrial companies to take out short-term loans abroad.[64] The central bank, however, was protected from the intervention of the state by the provisions set out at the time of the stabilisation.

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62 We wish to add that at the same time the Austrian National bank and the German Reichsbank took the same actions and had the same level of bullion reserves.

63 Gy. KOVÁCS, A bankrendszer és stakeholderei történeti megközelítésben, in: K. BOTOS (ed.), *A bankrendszer és stakeholderei*, Szeged 2006, pp. 54–109.

64 *National Archives of Hungary. General Archives*, MNL OL, K 269, Ministry of Finance, General Documents, parcel 518, item 1, parcel 515, item 1.

The new legal tender, "pengő" was introduced on 1 January 1927.[65] According to the conversion rate 12,500 koronas equalled one pengő, one kilogram gold was worth 3,800 pengő.

Reconstruction Crisis and Credit Expansion

The League of Nations reconstruction period ended on 30 June 1926, for which reason Hungary requested the termination of financial control. Smith high commissioner left the country shortly, but as there were still significant amounts to repay from the League of Nations loans Royal Tyler stayed in Budapest as an observer.

The stabilisation austerities resulted in a so-called reconstruction crisis by 1925–1926. The rate of unemployment grew significantly reaching the level of 15% and the real wages per one worker also fell considerably. The restrictive interest and credit policy, the rigid keeping of the pound rate resulted in the 20% appreciation of the Hungarian currency putting high pressure on the already significant problems of the export sector.

The official interest rate was extremely high at the beginning of the reconstruction, and the financial institutions/banks found a way to further increase it by charging higher costs under the titles of commission and management fee. This resulted in even the highest-ranking debtors having to count on interest rates of around 10%. In the country 13–14% was general, moreover, 17–20% interest rates were not infrequent either. The process moved the financial governance to take firmer steps and the minister of finance declared that he would not be averse to regulating the issue legally either. As the minister wanted to avoid every appearance of intervening with the interest rate policy of the central bank the only goal was to make sure that the credit organisation was tightly following the interest rate objectives of the Central Bank. Surprisingly, precisely the National Bank was against this goal even though it did not find the principles of the regulation opposing the laws of the economic life or the operation of the Central Bank.[66]

The high interest rates of the domestic loans channelled the credit demands to the direction of foreign loans. The domestic credit hunger and the foreign capital abundance found each other. The League of Nations loan and the security of foreign financial control changed the traffic light to green opening a tide of private loans.

65 Pengő as a calculation value had already been introduced earlier, in November 1925.
66 Documents of the Credit Department of National Bank of Hungary. National Archives of Hungary. General Archives (1925–1926), MNL OL Z, parcel 15, item 4.

We can gain information about the inflowing foreign capitals in the years between 1926 and 1930 based on the balances of payments. According to these data the following amounts of new foreign loans flew in the country: 168.7 million pengős in 1926, 294.6 million pengős in 1927, 299.8 million pengős in 1928, 234.4 million pengős in 1929 and 320.3 million pengős in 1930. The main reason for the flow of foreign capitals – as we could see – was abundance abroad, on the one hand, and the appeal of the high interest rates achieved in Hungary, on the other hand, which pushed the considerations arising in terms of the bearing capacity of the Hungarian economic life to the background. In addition to the quantity of foreign loans taken out by the banks within a few years the short-term debts of the financial institutions also grew conspicuously.

Conclusion

During the interwar period, economic and financial reorganisation of the Central and Eastern European countries were carried out by granting of international loans. In the post-war years, the victorious Entente Powers recognised the importance of stabilizing the region both economically and politically to avoid the spread of the Bolshevik regimes and any possibility of potential revolution. Another important objective was to foil the resurgence of the Mitteleuropa Plan in East Central Europe.

According to the prevailing economic thinking in the 1920s, budgetary equilibrium and the stability of the exchange rate were considered as the most important preconditions to achieve sustainable economic growth by curbing inflation and raise the rate of capital accumulation. All countries of the region stabilised their economies with substantial loans of the League of Nations or with the participation of international consortium of commercial banks. From the very beginning, Czechoslovakia was the only country in East Central Europe, which could successfully implement its economic consolidation. Based on domestic resources, the Czechoslovak crown was stabilised in the Spring of 1919 and was tied to the gold and dollar. Other countries of the region were compelled to introduce austerity measures that implied the reduction of public expenditures and the increase of revenues. Finally, the creation of central banks on an internationally recognised pattern served to restore the confidence of Western creditors to these countries. Although inflation was halted and the balance of the budget was achieved, the unusual high nominal interest rate of the international loans, which varied between 7 and 8.5%, was meant an additional burden on the national economy.

Post-war inflation in the years 1918–1924 was accompanied by a deflationary period. The latter led to a cash shortage, which had harmful impacts on domestic accumulation and economic growth. Monetary scarcity was further exacerbated by the fact that because of hyperinflation a considerable part of the accumulated capital was depleted. As Berend and Ránki rightly noted that by the Summer of 1925, the sum of total deposits was still only 11% of the pre-war level.[67]

Although financial reconstruction in Central and Eastern Europe contributed to the end of the economic chaos in the post-war years, the problems of low capital accumulation, poor investment rate and high indebtedness still remained in most of countries of the region.

The Hungarian stabilisation scheme also focused on monetary and budgetary issues and did not cover the recovery of the economy. The League of Nations agreement and control, however, offered a guarantee to the international creditors: the country had an economic policy, which guaranteed the repayment of the instalments and the payment of the interests. The political objective of the League of Nations loan outwardly was to make the system presentable and its economic goal was to maintain the solvency of the country.

As we saw it, Hungary stabilised the state financial affairs much faster than anybody would have expected. The balance was restored fundamentally because due to the stabilisation of the value of korona, the lifting of turnover restrictions and the growth of solvent demand the state tax incomes grew much faster than planned. The introduction of the gold currency standard, however, made the enforcement of a monetary policy in which the considerations of improving, supporting the domestic economy would have dominated, impossible.

The take-out of foreign loan was explained by the government by stating that after the stabilisation the potential deficit of the state budget would be covered from that loan to avoid another inflation generating money supply. Yes, however, for a very short time in reality: The deficit of the state budget had to be financed from the yield of the loan until the autumn of 1924 and such utilisation amounted to 70 million gold koronas. Many were on the opinion that this amount could have been produced from internal funds, too.

[67] BEREND – RÁNKI, *East Central Europe in the 19th and 20th centuries*, p. 88.