

German-Bulgarian Relations in the Inter-war Period: a Case of Monetary, Economic and Political Dependence

By Vera Asenova

Submitted to
Central European University
Department of International Relations and European Studies

*In partial fulfillment of the requirements for the degree of Master of International
Relations and European Studies*

Supervisor:
Professor Julius Horvath

Word Count: 16,170

**Budapest, Hungary
2007**

Abstract

The present work analyzes the economic relations between Germany and Bulgaria in the interwar period from the perspective of monetary power. It studies the dynamics and asymmetry bilateral clearing trade, the system of international payment through blocked accounts without the use of foreign currency in the context of tough exchange rate controls.

The theoretical approach used follows Jonathan Kirshner's theory of monetary power and the analysis of trade dependence advanced by Albert O. Hirschman.

It further brings a detailed historical evidence of the various aspects of these relations based on the literature and on original findings from archival sources.

The clearing trade is examined in the context of the general shift from a free trade to bilateral and multilateral regime which characterizes the interwar period. A debate on the motivations and effects of the clearing trade is further developed discussing the role of monetary liquidity as an instrument of choice.

Acknowledgements

I would like to thank the department of International Relations and European Studies for providing me with a research grant, which enabled me to use the Bundesarchiv in Berlin; I am grateful to my supervisor Prof. Julius Horvath for the ideas he gave me on this topic; to Nikolay Nenovsky and Kalina Dimirova for the useful references and comments; to my colleagues Chris Liedtke and Bela Filep for their help in translation and to Ivelina Yonkova for many valuable discussions.

Table of contents

Introduction	5
Chapter 1: Monetary dependence – theoretical approach	9
1.1 Kirshner’s analytical framework	9
1.2 International Trade and Power – Hirschman’s approach to dependence	11
1. 3. Bilateral clearing as a mechanism of monetary dependence	15
Chapter 2. The international conditions and the change of world order after WW I	19
2.1. Utopian and realist perceptions and why they are important.....	19
2.1.1. <i>The utopian mode</i>	21
2.1.2. <i>The realist mode</i>	24
2.2. The German drive to the East.....	26
2.3. Why Bulgaria becomes a “natural” trading partner of Germany?.....	28
2.3.1. <i>Economic crisis</i>	28
2.3.2. <i>Political isolation</i>	29
2. 4. The German drive to the Baltic States as an alternative perception of the East....	31
Chapter 3. Mechanisms and effects of the clearing agreements between Germany and Bulgaria.....	35
3.1. Chronological review	35
3.1.1. <i>Bulgarian – German trade in the 1920s</i>	35
3.1.2. <i>Bulgarian – German trade in the 1930s</i>	39
3. 3. The structure of clearing agreements	40
3.3. 1. <i>The initial clearing agreement</i>	40
3.3.2. <i>The Big Tobacco Compensatory Deal of 1934</i>	41
3.2. Clearing trade as concentration of power.....	43
3. 3. Financing international trade under bilateral clearing.....	46
3. 3. 1 <i>The clearing house</i>	46
3.3. 2. <i>The Commercial Banks</i>	47
3. 4. The effects of bilateral clearing on the Bulgarian economy.....	48
3. 4. 1. <i>Monetary effects</i>	48
3.4. 2. <i>The terms of trade debate</i>	51
3.4. 3. <i>Trade effects</i>	55
Conclusion	62
Bibliography	63

Introduction

“Trade is a social act”

J.S. Mill

“If we strive for money it is because it offers us the widest choice of enjoying the fruits of our efforts. ...money is one of the greatest instruments of freedom ever invented by man.”

Friedrich A. V. Hayek, 1944¹

The dynamic relationship between economics and politics, between market and state is often addressed in terms of one being the tool for the achieving the goals of the other. Nevertheless, the empirics provide a blurred division between political and economic action. This is especially true at the international level where foreign policy, foreign trade and security are strongly interrelated and constitute different aspects of power.

The present work analyzes the dynamics of power; the asymmetry rather than the balance of power between Germany and its small Southeast European partners in the inter-war period. In particular it will look into the mechanisms of gaining power and the subsequent effects of resource distribution between the core and the periphery. The periphery is represented by the experience of Bulgaria as it developed the strongest degree of dependence on trade with Germany and also because the German attempts to “attach” the economies of South Eastern Europe to its own were most successful in Bulgaria². The analysis reveals how international monetary relations and foreign trade become the main tool used by Nazi Germany to secure and advance the development of its war economy in a period of complete change of the international system. In the context of dependency

¹ Friedrich Hayek, *The Road to Serfdom*, (London: Routledge Paperback 1991 [1944]), 67.

literature money is rarely the focus of attention. Unlike more obvious categories like exploitation and extraction monetary dependence remains the invisible but fundamental mechanism of exercising power.

The development of close economic relations between Bulgaria and Germany after WWI is an example of how money was used as a tool to subject one country's production, export and political development to the interest of another country. The multilevel close relations between Germany and Bulgaria were a part of a planned eastward expansion of German economic and political influence. It was a reaction to the international isolation Germany faced after the war and turned into a decisive factor for its economic recovery. Germany and Bulgaria developed extremely close relations in that period both on the economic and on the political level.

Studying the mechanisms and effects of German expansion in Bulgaria has wider applications than simply revealing the history of bilateral relations. It is a part of a wider shift from one international order to another – from the regime of free trade and international gold standard, to a regime of bilateral clearing agreements and strict foreign exchange control. This shift occurs as a more or less logical consequence of WWI, which brought about a general mistrust among nations. A preference for autarky and national control over domestic production, international trade and foreign exchange became almost universal in Europe. Nevertheless, looking into the details of how it took place reveals important theoretical considerations.

² E.A. Radice, "The German Economic Programme in Eastern Europe", in *The Economic History of Eastern Europe 1919 – 1975*, Vol. 2 ed. M. C. Kaser, (Oxford: Clarendon Press, 1986), 300.

The proposed research aims to look into the mechanisms of change and the sources of power, which legitimized and maintained the “New Order”³. Germany adapts itself to the Versailles Treaty and the post war economic crisis by expanding eastwards. The New Order aims to secure the supply of cheap raw materials, necessary for its industrialization and later militarization. A part of it was the mechanism of bilateral trade agreements with the weaker east European countries. Among them Bulgaria developed the highest level of economic dependency, which later materialized in a military alliance with Germany in WWII⁴.

The clearing agreements are highly debated in terms of their effects and driving motives. The proposed thesis is an attempt to understand the fundamental motivation of the two countries’ governments, the effects pursued and actually gained from this cooperation. It draws some conceptual conclusions about the nature of international economics and politics in the period. The participation in any international system of rules requires giving up some national autonomy, and it is difficult to tell exactly where and when the benefits of participation are less than the costs of exit.

The three main questions dominating this work are (i) what are the mechanisms of monetary dependence; (ii) how was the shift from independence to dependence achieved; (iii) how were these relations perceived in their own time.

Chapter one presents the theoretical framework of the thesis – a combined approach of foreign trade dependence and monetary dependence outlining the typical mechanisms of subordination of one country’s economy to another. The majority of

³ The plan for expansion in the east is termed by the Nazi bureaucracy the “New Order”.

⁴ Ibid.

literature on the inter-war economic relations focuses on studying the dynamics of economic criteria like terms of trade, exchange rate, inflation and income as approximations of wealth and power distribution. The use of these measures, all derived from monetary prices, for analyzing the international economic relations of the thirties obscures the main characteristic of the period – the changing role of money from a means of exchange to a means of coercion. To explain the mechanism of this transformation I will use mostly the theoretical framework of monetary power developed by Jonathan Kirshner (1995) and the earlier contribution of Albert Hirschman (1945) on trade dependence.

Chapter two will present the broader framework of the international conditions of the thirties, which subject the driving motives of the two countries for becoming closely related. It will discuss the objective constraints of the world order and the particular motives and ideas, which influenced the drive towards one another. The shift from a free trade to a regime of bilateral clearing agreements is approached from a more structural perspective is seen as a reaction to changing economic and political conditions. It was the adjustment strategy of each country to these change that

Chapter three provides evidence in support of some theoretical claims made earlier based on the literature and archival materials. It consists of the debate on the effects of these relations without trying to have a final say in it. The work as a whole is an attempt to reveal the mechanism of monetary dependence while arguing it is a form of economic and political dependence and a source of power.

Chapter 1: Monetary dependence – theoretical approach

Monetary power is an important, yet underresearched aspect of power in international relations and political economy. It is examined in the following chapter both in terms of its causes and sources and its consequences. As opposed to seeing power as the reason for unequal wealth distribution among nations, it deals with the sources of monetary power in the international monetary system. These are mainly the asymmetries of trade concentration as a source of power and the mechanisms facilitating international payments. Monetary power arises from the way we trade and the way we pay which is analyzed in detail in the following chapter.

1.1 Kirshner's analytical framework

There are many theoretical approaches to explaining economic and political dependence. Among them few have considered monetary dependence as the proper unit of analysis. Monetary dependence is a form of monetary power and is analyzed in detail by Jonathan Kirshner⁵. He examines how international monetary relations are used as an instrument of coercion “to advance security-related or other non-economic goals”⁶. While in Kirshner's analysis the issue of monetary power is isolated from other forms of economic diplomacy, this isolation is strictly theoretical and aims to focus on its mechanism. This mechanism occurs as a result of some changes in the economic conditions and international relations. Therefore chapters two and three will provide a broader political economy approach to monetary power. Monetary power lies at the

⁵ Jonathan Kirshner, *Currency and Coercion: The political economy of International Monetary Power*, (Princeton: Princeton University Press, 1995).

⁶ Ibid., 4

intersection of the economic analysis of efficiency; studies of international monetary cooperation and the distributive effects of different monetary regimes. While efficiency studies remain “blind to the concept of power”⁷, distribution effects overlap with monetary power. It is these effects that were particularly strong in the relations between Bulgaria and Germany in the 1930s.

In Kirshner’s framework, monetary power can be exercised in three ways – (i) currency manipulation, (ii) monetary dependence, (iii) systemic disruption⁸. Currency manipulation affects the monetary stability of a country through attacks on the exchange rate of its currency. Under a fixed exchange rate, the pressure could result in a decrease of reserves or a balance of payments crisis. Under a flexible exchange rate this could move the currency away from the preferred value of the exchange rate, create chaos in the economy by hurting consumers of tradable goods and exports or hurt the reputation of the currency and the legitimacy of the government⁹. Such a policy is costly both to undertake and to counteract and from Kirshner’s examples it seems to be applicable among relatively equal economic powers (“the French crusade against the dollar exchange standard in the 1960s”)¹⁰. It was not related to the Nazi economic expansion in Southeastern Europe, where the main form of monetary power used was monetary dependence. This is exercised by the creation of a sphere of influence – a currency bloc, which is a mechanism of insulation from the outside world¹¹. The formation of a currency bloc is more likely when the international environment is hostile, or in times of depression and economic disturbance. It consists of a core – a leader state that is the issuer of the core currency and

⁷ Ibid., 5

⁸ Ibid.

⁹ Ibid.

¹⁰ Ibid., 18

a periphery – the members of the block whose exchange rates are fixed to the core currency. The third form of monetary power, systemic disruption, is the actual disruption of the monetary arrangements of the whole system, “as opposed to particular currencies”¹², which destroys its arrangements in order to extract certain benefit. This strategy is usually directed toward the core currency. Systemic disruption and monetary dependence are mutually excluding strategies as the members of the block have a common interest in sustaining the system. “Participation in such an organization shifts the preferences of the target state toward harmony with those of the home state.”¹³

1.2 International Trade and Power – Hirschman’s approach to dependence

The type of monetary power exercised by Germany according to this classification is monetary dependence. The meaning of the dependence used needs to be differentiated from the meaning dependency theorists assign to it and contextualised in the literature. Kirshner builds on the classical contribution of Albert O. Hirschman – *National Power and the Structure of Foreign Trade*¹⁴, which analyses the dependence relations as a result from trade. Unlike dependency theory, which is concerned with the reverse causality, the trade and economic conditions arising from dependency, Hirschman examines “the possibility of using trade as a means of political pressure and leverage”¹⁵ where “dependence” is understood as economic vulnerability. Hirschman’s analysis of the structural characteristics of international economic relations provides us with a theory of economic power and ways to measure it. He sees this system as conducive to power

¹¹ Ibid.

¹² Ibid., 8

¹³ Ibid., 13

maximization or it “makes the pursuit of power a relatively easy task”¹⁶. “The Nazi party, according to this point of view, had not perverted the international economic system, they had capitalized on one of its potentialities”¹⁷.

Hirschman defines international trade as a “political act”¹⁸ no matter what kind of international trade regime exists. In his view the ideal economic type of mutually beneficial free trade is not a realistic one due to existing asymmetries between rich and poor, big and small, industrial and agricultural countries¹⁹. These differences result in differences in gains from trade and trade concentration. When a country trades with another country it is still true that both countries gain, but these gains are asymmetric. The richer country is usually the one that has a more diversified trade, both in terms of partner countries and goods traded, that is, it can export a variety of goods to a variety of markets. The poorer country usually has its exports concentrated on the market of a certain big country, which can be more than 50 per cent of its total foreign trade. At the same time, for the big country the trade with the small one could be less than 5 per cent²⁰. “German-Bulgarian trade in 1938 ... represented 52 and 59 per cent of Bulgarian imports and exports, respectively, but only 1.5 and 1.1 per cent of the German imports and exports”²¹. The combined share of Bulgaria, Yugoslavia, Romania, Greece and Turkey of the total German trade was not more than 4 to 13 percent during the period of the 1930s²².

¹⁴ Albert O. Hirschman *National Power and the Structure of Foreign Trade*, (Berkley: University of California Press, 1980, reprint 1945)

¹⁵ Ibid., v.

¹⁶ Ibid. vi

¹⁷ Ibid., vii

¹⁸ Ibid., 13

¹⁹ Ibid

²⁰ Ibid., 30

²¹ Ibid., 30

²² Liudmila Jivkova, “German Economic Expansion to Bulgaria (1933-1939)”, in Georgi Markov (ed.), *Bulgarian-German relations Volume I*, (Bulgarian Academy of Science, 1979) (in Bulgarian), 375.

Because the same nominal quantity of trade is more important for one country than for the other, a dependency relationship occurs. He also points that the difference between industrialized and agricultural countries results in a certain product specialization, which ties the countries into a dependency relationship. The poor countries, due to a similar export structure, do not trade with each other, which poses additional limits to their foreign trade orientation. A deliberate “prevention of industrialization or even the removal of already existing industries”²³ is a way of maximizing the dependency of a small agricultural country on an industrial one.

The fact that the same volume of trade has different relative importance for the two partners is a source of dependence, but this dependence is also factored by the dependent country’s “willingness to accept economic (or physical) punishment”²⁴. Hirschman suggests that the smaller countries devote disproportionately greater attention to the dependence relationship, which gives them an opportunity to develop an opposition to it and threaten the stability of this relationship²⁵. Nevertheless, this is not the case of Southeast European states’ relations to Germany. Using another one of Hirschman’s theories, these countries’ “exit” from the system was too costly, their “voice” was silenced and their “loyalty” was abused²⁶. The question that arises is how this dependence was technically instituted. The way interests diverted and resources are reallocated becomes clearer when looking into the specific techniques of organization of trade in this period.

²³ Albert O. Hirschman *National Power and the Structure of Foreign Trade*, (Berkeley: University of California Press, 1980, reprint 1945)., 25

²⁴ Ibid., viii

²⁵ The example given is the relations between the United States and the Latin American countries, ix

²⁶ Albert.O. Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard University Press, 1970)

Hirschman deals with the structural specifics of the international system as a whole and intentionally leaves the technicalities aside²⁷.

On the other hand, Kirshner's approach builds on his development and specifies monetary dependence as an instrument for maximizing power and influence. As a mechanism of economic dependence "monetary power may provide a relatively greater number of opportunities to coerce states with which the home state is traditionally friendly than do other forms of influence."²⁸ Monetary power is different as opposed to other forms of power as it is always a state monopoly; it has no particular societal group associated with it and therefore pressures and opposition is minimal or muted; the monetary system is "mysterious" to non-experts and could be exercised privately. Therefore Kirshner claims that "monetary power should be the most potential instrument of economic coercion available to states in a position to exercise it."²⁹

Monetary dependence as described by Kirshner results from three factors: (i) the asymmetric distribution of benefits from membership in an international monetary bloc; (ii) the costs of exiting such a system; and (iii) changes of the preferences of the target country. It can take the form of enforcement, expulsion, extraction and entrapment. The main objective of Germany's foreign economic policy in the 1930s was to entrap its small neighbors and to alter their preferences in harmony with German interests, which allows for a silent extraction of wealth. "Entrapment is the transformation of interests... at the level of the firm and of the level of the government"³⁰. These forms have been analyzed by

²⁷ Ibid., vi

²⁸ Jonathan Kirshner, *Currency...* 277

²⁹ (Ibid., 31)

³⁰ Ibid., 118

Hirshman on the level of trade, but they are even greater in monetary relations due to the above described characteristics of monetary power.

1. 3. Bilateral clearing as a mechanism of monetary dependence

The specific monetary relations Germany developed with Bulgaria were conditioned by the Great depression and raised the benefits from participation in a monetary system. The collapse of the Austrian Creditanstalt in 1931, which then spread into Germany and other countries, led to suspension of the convertibility of currencies and introduction of exchange control as a safeguarding measure³¹. A definition of exchange control by Michael Heilperin corresponds to the potential for monetary power described by Kirshner. “Exchange control consists in centralization of all dealings in foreign exchange in the hands of a public authority (treasury, central bank or an institution created ad hoc)”³² This posed severe restrictions in the movement of foreign exchange and resulted in blocking international transfers. At the absence of convertible currency, international trade financing was organized through bilateral clearing accounts without the use of currency.

The system functioned in the following way: importers pay for imports by depositing national currency in a blocked account at their national monetary authority (usually the central bank) held in the name of the exporting country. A parallel account is established in the central bank of the partner country where their importers pay with national currencies. Domestic exporters received their payment from the central bank in their national money. This means that trade always has to be in balance, the deposits of the

³¹ Ibid., 123

³² Michael, Heilperin, *Control of International Trade*, (London: Routledge, 1939), 238

importers should equal the claims of the exporters in order for the accounts to clear. In reality though, trade was never balanced and in case of export surplus the importers' deposits were insufficient to pay the exporters.

There were two options for paying the exporters depending on the central bank's preference – waiting and financing principle. Under the waiting principle, the exporters would not be paid until new imports from the same country are bought. They would receive their claims from the deposits of importers in the chronological order of their claims. In contrast, under the financing principle the central bank would pay the exporters with newly issued domestic currency, “backed” with the claims against the central bank of the partner country. The financial principle is not without variation. The target country central bank can chose whether to support the fixed exchange rate or to let the exchange rate of the Reichmark devalue relative to their own currency³³.

³³ Lary Neal, “The Economic and Finance of Bilateral Clearing Agreements: Germany, 1934-8”, *The Economic History Review*, Vol. 32, No. 3, (Aug. 1979), 400

Figure 1. Bilateral Clearing – balanced account³⁴

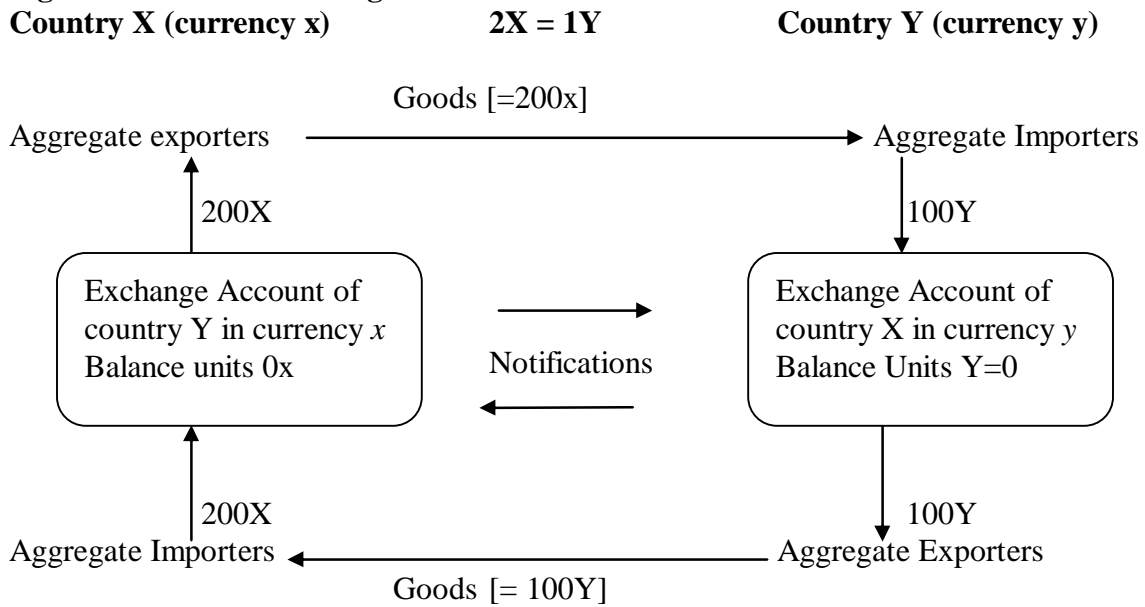
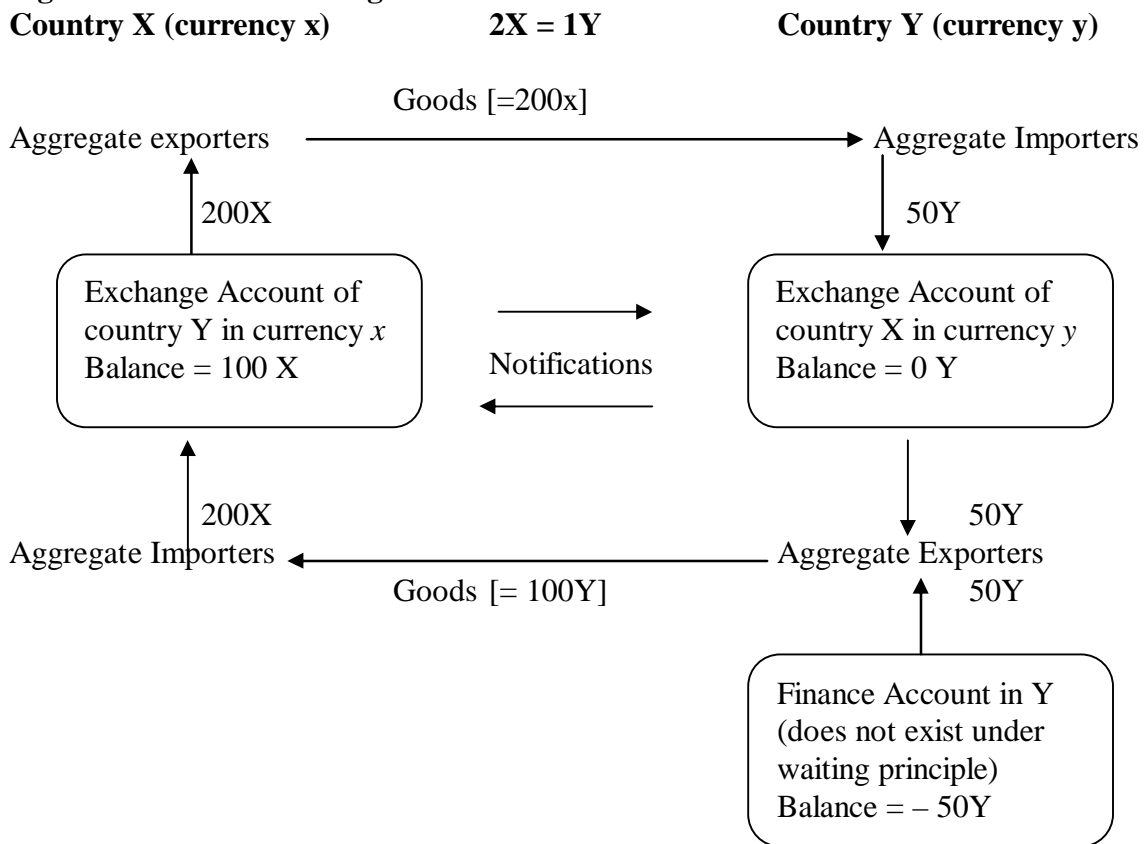


Figure 2. Bilateral Clearing – unbalanced account³⁵



³⁴ Jonathan Kirshner, Currency..., 125

³⁵ Ibid., 127

The different policies and their effects will be analyzed in greater detail in chapter three. Germany had a strong preference for its partners to use the financing principle, which would allow her to increase its supply of foodstuffs and raw materials without export of capital from Germany. Used initially as a defense mechanism against capital outflow, the exchange control and the bilateral clearing soon develop as a mechanism of entrapment of the small Southeast European states. Entrapment was higher for countries practicing the financing principle. This policy involved a transformation of the interests of the small country in order to harmonize with the interests of the bigger country. In order to defend its agricultural exporters (and often to promote their high cost intensive products) the central bank found itself forced to finance the German imports of raw materials, much needed for its rearmament.

The monetary approach to entrapment complements the trade approach of dependence and advances the explanation of broader implications of power and coercion. The lack of free foreign exchange, which is almost taken for granted today, gave way to lack of the freedom to choose one's partners, import goods and revenues and lead to an extreme extent of economic dependence. The fact that it hit the poor, agricultural and least industrialized countries in Europe shows that monetary freedom is closely related to wealth. A conceptual understanding of money as choice and of exchange control as limitation of freedom can be derived from the theoretical debate on monetary dependence. An interesting question is if the world system is naturally prone to dependence relations what makes certain limitations of freedom acceptable in a particular period of time. What are the subjective expectations and the objective limits to of this shift and how do they interact is the subject of the following chapter.

Chapter 2. The international conditions and the change of world order after WW I

Chapter two will analyze the changes in world economic order after WWI which are seen as crucial to the formation of the specific power relations between Germany and Bulgaria³⁶. Beyond the strictly objective and structural realities it will look into the predominant perceptions at the time, which shaped the motivations and expectations of foreign economic policy.

2.1. Utopian and realist perceptions and why they are important

The theory of monetary dependence is a useful tool for analyzing monetary channels of power mainly because it allows a dynamic interpretation of power. It acknowledges the changing purpose of the monetary mechanism from an instrument of defense and insulation to a mechanism of resource extraction. Following the theory's rationale it can be argued that negative consequences of the Great Depression increased the benefits from engaging in bilateralism and brought countries together currency in a isolation groups. The monetary insulation was achieved by entering a currency bloc. After the economic recovery takes place it should be expected that countries preference for insulation declines.

Indeed the economic recovery of Germany proved that protectionism and exchange control, established in 1931 had worked well for preventing capital outflow and sustaining the exchange rate. After the economic depression was overcome it was sought

³⁶ Using countries as a unit of analysis of power is a common, though not entirely correct approach. It cannot be determined with certainty what was the total effect of these relations for each country. It is rather is certain groups who gain and loose from their position in the monetary system. Since the

to use this arrangement on a broader scale as a foundation of enlarging the economic and political influence of Germany.

Looking into the German – Bulgarian relations in the 1930s one could easily conclude that Bulgaria was in a disproportionately negative position. It developed the greatest economic dependence on Germany among all Southeast European states, transferring most of its production surplus to Germany (more than 50 per cent of the total exports of the country³⁷). At the same time German exports were severely restricted to what Nazi government found suitable to leave the domestic economy. Due to the specific mechanism of bilateral clearing Bulgaria became in effect a creditor (both in kind and financial) to the German government accumulating claims for 900 m Reichsmarks. This debt was never repaid as the Bulgarian financial claims were annulled at the Paris conference in 1947³⁸.

A quick conclusion and evaluation of the net effects will suggest that the Bulgarian economy has been subjected to the ends pursued by the German foreign and domestic policy which would be a one sided and too limited interpretation of the relations of the time. A deeper analysis of the driving motives and expectations of both states disproves the overly passive role often assigned to the Bulgarian government and reveals that in fact it acted in accordance with its national interests and expectations for their satisfaction. Some authors claim that Germany also had an interest in Bulgarian economic development and agricultural modernization as these would provide a much needed market for German

concentration of the paper is predominantly on the mechanisms then on the effects of power, the two countries will be examined as if they were more or less “unitary actors” for reasons of simplicity.

³⁷ See Table 1. Clearing and non-clearing trade of Bulgaria

³⁸ Markus Wien Market and Modernization. German-Bulgarian economic relations 1918 – 1944 and their conceptual basis” presentation at the Institute for Liberal Strategies, Sofia.

industrial goods³⁹. The theoretical question that arises is then if both states act in accordance with their interests why does Bulgaria end up being the loser of this agreement? What was the reason it could not defend its position?

2.1.1. The utopian mode

A proposed answer is that Bulgarian foreign policy adopted an ethical principle as its main bargaining strategy. This means it based its claims for a better treatment and adherence to the agreed contracts on the principle of fair treatment. This is the predominant principle in a free trade world as it was the case before WWI. In the 1930s however, when mutual distrust and fear caused countries to insulate themselves from the global economy, ethical principles of international relations lost their persuasive power.

A conceptual framework suitable for approaching this question is the developed by E.H. Carr distinction between utopianism and realism in international relations⁴⁰. Carr's approach to the study of history in general can be applied to the study of the German-Bulgarian inter-war period relations. Presenting the classical liberal views on international relations theory as utopian, he points that "condemnation of the past based on ethical grounds has no meaning; ... what was right"⁴¹. The hypothesis of this chapter is that perceptions are also conditioned by the structural characteristics of the system and the ethical based argument in foreign economic relations is the last source of argumentation for an actor with limited economic and political resources. An argument in favor of a certain order is ethical if it claims for example more symmetric distribution of gains from trade

³⁹ Ibid.

⁴⁰ E.H. Carr, *The Twenty Years Crisis 1919-1939: An Introduction to the study of International Relations*, (London: Macmillan, 1939 [1939]).

⁴¹ Ibid., 67

because this is just. It would be used in case where there are no other resources for advancing, let alone imposing one's interest.

In the case of German –Bulgarian relations I hypothesize that the Bulgarian foreign policy towards Germany was indeed based on utopian understanding about the nature of international relations and not on analysis of the current situation and its alternatives.

On the contrary German foreign policy was a rational and planned economic and politic expansion to the east, a reaction to the economic and financial constraints that were in place. In effect this changed Germany's position from a partner in a free trade regime to a hegemon in a regime of clearing agreements system. This behavior falls under one of Carr's definitions of realism but contradicts another one of its aspects. These concepts will be challenged against an empirical example.

Carr defines utopianism as a theoretical approach to the study of international relation, which is based on universal principles like free trade, self-determination and collective security⁴². With little account of the facts the utopian approach is based on the expectation that the world is what it would be and not what it in fact is.

“The utopian is necessarily a voluntarist: he believes in the possibility of more or less radically rejecting reality and substituting his utopia for it by an act of will. The realist analyses a predetermined course of development which he is powerless to change”..... The utopian fixes his eyes on the future, thinks in terms of creative spontaneity: the realist rooted in the past, in terms of causality⁴³.”

He acknowledges that all healthy thought must establish a balance between these two ideal type of models⁴⁴. Carr leaves an open question as to how in reality the utopian

⁴² Ibid. 12

⁴³ Ibid., 11

⁴⁴ Ibid., 13

and naive approach could be ignored since it is also an initiating one and how the realist approach, taking account of the facts does, remain inactive and “sterile”⁴⁵.

The understanding of realism, suggested by Cox (1996), is more useful for interpreting practical problems⁴⁶. Realism as a theory based on facts about “what kind of action does the current state of international order permit”⁴⁷. The notion of “framework for action”⁴⁸, which poses certain constraints is more relevant approach to the German foreign policy in the inter-war period than the passively observing role of a realist. It is not completely divorced from the utopian mode because by undertaking the appropriate actions according to the externally defined conditions it does in fact change the broader conditions on purpose. If one is looking for a consequential relationship between social phenomena it would be unrealistic to suppose that a realist theorist will not prescribe a certain reaction to the changing configurations of power. On the other hand a utopian, who is driven by aspiration, cannot possibly act out of the real world circumstances. This action will be contextualized in a causal relationship which in turn will modify the aspirations however unrealistic they may be.

While the foreign policy decisions of both states were constrained by the circumstances of the Great depression, the Versailles Treaty and the shortage of financial resources⁴⁹, their decisions were to a great extent independent and autonomous. Bulgaria was not forced into agreement with Germany; rather the German political elite and its economic experts was in a position and had the interest to offer what the Bulgarian

⁴⁵ Ibid., 12

⁴⁶ Robert Cox, *Approaches to World Order*, (Cambridge: Cambridge University Press, 1996).

⁴⁷ Ibid., 95

⁴⁸ Ibid.

⁴⁹ Which was mainly due to the weakening of the role of Great Britain as a lender of international capital in the shift from British to American hegemony.

government saw as beneficial. In the view of Bulgarian historian Geori Markov: “the revisionist policy and the great Bulgarian chauvinism, which sought support in Berlin lead to an economic and political dependence⁵⁰”. Bulgaria traditionally valued highly its international reputation before. It sustained a reputation of an excellent debt payer before its creditors which was intentionally pursued. Good reputation was perceived as crucially important for obtaining certain debt relieves⁵¹. Bulgaria had the expectation of fare treatment and a mutually beneficial relationship – a projection of the ethical principles of free trade operational before the WWI. These principles proved to be unrealistic and the more importantly inefficient in the conditions of autarky as neither debt relieves, nor fare trade was achieved. The ethical argumentation and the position of a loyal trade partner did not deliver the economic and foreign policy results Bulgaria pursued.

2.1.2. The realist mode

Germany on the contrary adopted a realistic approach based on the interest in securing cheap raw materials through monopolizing foreign trade as well as securing the domestic support for the Nazi regime by limiting export of domestic surplus⁵². Germany realized sooner and better that the principles of free trade are going to be replaced and proved flexible and able to adapt its foreign policy to the changing international order. At the same time it was utopian enough to pursue a change of the order itself as it would best suit its policy.

⁵⁰ Georgi Markov, “Bulgarian-German Relations 1931–1939”, BAS , Institute of History, Sofia: 1984., 37

⁵¹ Martin Ivanov, 2005, in Nenovsky, Pavaneli, G., Dimitrova, K. ”Exchange Rate Control in Italy and Bulgaria in the Interwar Period. History and Perspective”, Southeast Europe Monetary History Network Viena, 2007 forthcoming.

⁵² Paul Einzig, “Hitler’s ‘New Order’ in Theory and Practice”, *The Economist Journal*, Vol. 51, No. 201, April 1941

As opposed to a free trade regime where countries exchange goods in return for convertible currency and are then free to use this currency for purchasing goods wherever they find it profitable, under a bilateral clearing regime two countries exchange goods without the intermediation of currency. After the complete cessation of American loans to Europe in autumn 1929 the European countries (especially the debtor countries) faced a shortage of convertible currency and financial assets after large transfers of gold to the US created artificial scarcity of gold which pushed prices down⁵³. This led to the introduction of various measures for the control foreign currency movement and the prohibition of gold drain from the US in October 1931⁵⁴. In order to protect the domestic agriculture producers from the falling prices measures like tariffs, quotas, import restrictions, export subsidies were introduced, which limited free trade and established protectionist market environment. In this context Germany was particularly vulnerable due to high reparation payments after WWI (132, 000m marks in 1921)⁵⁵ and a position of a debtor with effectively no convertible currency. Although realizing the importance of financing Germany, Britain was not able to lend at that time also due to limited assets, while the US had yet no articulate interest in preventing German isolation even though it had the biggest lending potential⁵⁶. France was the only European country able but unwilling to lend to Germany in its attempts to refinance its banking sector after the collapse of the Austrian

⁵³ E. H. Carr, *International Relations between the Two World Wars, 1919 – 1939*, (London: MacMillan, 1990 [1947])

⁵⁴ Ibid.

⁵⁵ H.W. Arndt, *The Economic Lessons of the Nineteen-Thirties*, (London: Frank Cass, 1972, [1944]), 26.

⁵⁶ E. H. Carr, *International Relations between the Two World Wars, 1919 – 1939*, (London: MacMillan, 1990 [1947])

Kreditanstalt spread to Germany⁵⁷. France also blocked Germany's attempts to establish a customs union with Austria in 1931.

The world economic conference of 1932 which aimed to bring back the system to a regime of low tariffs and fixed exchange rates failed. Not only Germany but the whole international system was shifting towards a new order of international trade.

In this context economic policy was the only tool available to German foreign policy after its military power was annulled. Therefore it makes sense to concentrate on the economic and trade order and its formation if we are to understand the broader shift in international relations, the changing type of state and further policy commitments. The central question however is not why but how did that shift occur or in Cox's framework what social forces – ideas, material capabilities and institutions provided for the change. Analyzing the material conditions of limited foreign capital and trade absence of sufficient domestic savings (the inflation of 1923 had depleted all savings) and rising unemployment together with the dominant perceptions of the time is used to explain the following relations with Bulgaria.

2.2. The German drive to the East⁵⁸

In the absence of military resources German foreign trade policy was effectively also “foreign policy”⁵⁹. In reaction to the changing conditions German foreign policy takes a position that can be described as both realistic and active. It decides and pursues a planned and systematic eastward expansion of its foreign economic policy and becomes the main

⁵⁷ France had the biggest reparation claims on Germany after the First World War so in a way it is “natural” for France to oppose further lending to the Germany.

⁵⁸ The East refers to the countries of Southeast Europe and the Baltic States without assuming they have a collective identity or policy. Neither does it refers to a common German perception of these countries.

trading partner of the countries in South Eastern Europe and of the Baltic States. However utopian it may have seemed at the time, Germany manages to surpass the British share of trade with the Baltic states and the French share in the Balkans⁶⁰. It managed to adapt itself to the change of world order by actively changing it in spheres it could control. The fact that the British and French relied on relations with their colonies for access to raw materials and foreign markets made the Balkans unattractive for them. Moreover by concluding the Ottawa trade agreement with its dominions Britain isolated itself from trade relations with other underdeveloped countries.

For Germany the Great Depression brought about a great opportunity for seizing the Balkans. All predominantly agricultural countries in need of modernization and lacking the convertible currency needed for freely choosing their trading partners faced a collapse of prices of their exports. Germany offered a solution to all three problems – it would buy at prices above the world priced (pre-depression prices) thus providing market, it would pay with industrial goods, machines and production facilities solving the problem of modernization and eliminating the need of currency. Because it had no means to force Bulgaria, Serbia, Hungary, Romania and Greece into exporting to Germany it had to offer acceptable and beneficial terms of trade⁶¹.

The new trade arrangement was indeed mutually beneficial largely due to the smaller countries depressed position where any trade would be better than no trade. The gains from trade, nevertheless were asymmetrically distributed. Bulgaria experienced a

⁵⁹ John Hiden, *The Baltic States and Weimar Ostpolitik*, (Cambridge University Press, 1987)

⁶⁰ Ibid.

⁶¹ The debate on the terms of trade and their effects is advanced in chapter three.

considerable economic growth with increase of production and export and it considered this a good deal for a substantial amount of time⁶².

2.3. Why Bulgaria becomes a “natural” trading partner of Germany?

2.3.1. *Economic crisis*

The term “natural” used here refers to the complementarity of economic structures, geographical location and monetary regimes and not to the political regimes and the ideologies of the two countries’ governments. It is used by many authors⁶³ to describe to the lack of alternative in Bulgaria’s foreign economic orientation. A few factors bring Bulgaria and Germany into a natural alliance from an economic point of view. After the Great Depression of 1930 which lead to a collapse of the prices of agricultural products Bulgaria’s need to export its agricultural production was the leading factor. In the political division of the world no other market demanded the Bulgarian agricultural production to the extent the German market did.

On the other hand Germany, although trying to stay as self sufficient and insulated from the world economy as possible, was still unable to provide itself with food and raw materials. The theoretical proposition that small poor countries do not trade with other due to similar structures of their economies, emphasized by Hirschman, has a strong

⁶² A. Christofoff, “The Course of the Trade Cycle in Bulgaria 1934-1939”, Statistical Institute for Economic Research, State University of Sofia. (in Bulgarian)

⁶³ See Allan G. B. Fisher, “The German Trade Drive in Southeastern Europe”, *International Affairs* (Royal Institute of International Affairs 1931-1939), Vol. 18, No. 2, March-April 1939.; Nikolay Nenovsky, Pavaneli, G., Dimitrova, K. ”Exchange Rate Control in Italy and Bulgaria in the Interwar Period. History and Perspective”, Southeast Europe Monetary History Network Viena, 2007 forthcoming. Also Georgi Markov, *Bulgarin-German Relations 1931–1939*, BAS , Institute of History, Sofia: 1984. (in Bulgarian)

validity for the Balkan economies - all agricultural countries at a very low level of industrialization.

2.3.2. Political isolation

In addition the political relations between the Balkan states did not allow for intensive trade. In 1930 Greece denounces the 1927 bilateral trade agreement with Bulgaria and thus practically declares a customs war and freezes the bilateral trade relations until 1938⁶⁴. After the signing of the Balkan Pact 1934, by Greece, Turkey Romania and Yugoslavia, Bulgaria is diplomatically isolated from all its neighbors. The Pact aims to cancel all territorial claims that the Balkan states might have against each other and to guarantee mutual respect of the current post WWI borders. Bulgaria does not sign the Pact due to its deep dissatisfaction with the peace treaty, which leaves about 10 per cent of its territory and 9 per cent of its population outside of its borders⁶⁵. These proportions are similar to what Germany ceded after the WWI – 13 per cent of her territory, and 10 percent of her population⁶⁶. Both countries adopt a revisionist foreign policy. Bulgaria feels naturally drawn towards these great powers which contest the peace treaties and in 1933-34 actively orients its foreign policy towards them⁶⁷. At the same time its claims towards Yugoslavia are rather silenced to the expense of claims against Greece. It is only in 1937 with the signing of the Bulgarian-Yugoslav Pact that Bulgaria steps out of its isolation.

The internal actors and interests groups for both Germany and Bulgaria had also influence for adopting the closeness in relations. According to Petzold, 1979 after the

⁶⁴ Ibid.

⁶⁵ Ibid.

⁶⁶ James Foreman-Peck, *A history of the World Economy: International Economic Relations since 1850*, (Harvester Wheatsheaf, 1983)., 189

WWI the German economy was dominated by the “monopolistic capital” which saw it beneficial to trade with the Bulgaria – able to export agricultural production and raw materials and potential market for ready industrial goods, due to its underdevelopment and need for industrialization⁶⁸ The political instability – the unsettled national question (as the territorial problem was called in Bulgaria) made Bulgaria vulnerable and a ground “suitable for expansion”. It also constituted an “economic reserve in the battle against the Soviet Union⁶⁹”. The German industrialists therefore made endeavors to foster fractions supportive of Germany in the Bulgarian Society against the strong traditional support for Russia and the growing workers’ movement. Petzold further claims that the industrialists financed the German colonialists in their eastward expansion, a statement rather ideological than substantial. John Hiden for example argues that it was only the industrialists who were oriented towards the west and not to the east.

Although Bulgaria did not have a strong presence of German minorities (like most of the countries under German influence), it was rich with German friendly circles. The German culture was respected and well known, the respect towards Goethe, Schiller, Kant and Einstein was used by the Nazi propaganda to proclaim the superiority of German culture over the culture of the Slavic nations⁷⁰. A decisive factor for the cultural relations was the German origin of King Ferdinand I and the war brotherhood in the World War I⁷¹.

⁶⁷ Georgi Marko, Bulgarian-German Relations

⁶⁸ Joachim Petzold, “On the Continuation of the Balkan Policy of the German Imperialism”, In *Bulgarian-German relations Volume II*, edited by Georgi Markov. Bulgarian Academy of Science, 1979. (in Bulgarian)

⁶⁹ Ibid.

⁷⁰ Liudmila Jivkova, The German Economic...

⁷¹ Ibid.

Archival materials from official reports during the King's visit to Berlin 1934 confirm that Bilateral relations are seen as "friendly and based on mutual sympathy"⁷². The report further states that Germany is not interested in the estranged political relations between the Balkan countries but recognizes that there cannot be a lasting solution without the agreement of Bulgaria⁷³.

2. 4. The German drive to the Baltic States as an alternative perception of the East

A variation in perception and therefore of policy can be seen against the Baltic states where Germany managed to take control over foreign trade in a competition with Britain. In contrast to Bulgaria the Baltic States are seen as a strategic route to Russia, a point of contact between the capitalist West and the communist Russia. The ports of Riga, Talin, Narva were major trade centers before the war where French, Belgian, Dutch, British and above all German capital induced a predominantly industrial growth⁷⁴. After 1919 the former glory of the Baltic ports was reduced to a agricultural production and the main goal of national policy was industrialization⁷⁵. "The Baltic utopia" of the 1920s in a way was that the old rhythms of foreign trade will reassert themselves in the postwar years. What made this utopia more realistic was that the ethnic Germans in the Baltic States constituted a considerable part of the local investors, bankers and businessmen so the German state was called into assisting the reindustrialization of the Baltics⁷⁶. This position of economic power modified the nature of the international relations. In 1920 the

⁷² Bundesarchiv, Berlin R 90140/682

⁷³ Ibid.

⁷⁴ John Hidn, The Baltic...

⁷⁵ Ibid.

⁷⁶ Ibid.

British literary controlled the Baltic ports⁷⁷. Their encouragement of trade was ad hoc more in line with the principles of free trade and limited government intervention. In the postwar years the German government adopted the role of a guarantor of contractual private corporations and was in a position of a creditor under a most favored nation regime. The difference in German priorities in the Baltics – strengthening the trade agreements and supporting the German minorities living there shaped a different approach than that in the Balkans. German foreign policy, although extremely self interested proved flexible enough to actually achieve its self interested goals. It was a realist based in its approaches to foreign policy action but still utopian in its foreign policy thought.

Conclusion

While most countries faced serious adjustment problems after the Great War there seems to be little recognition of the change in the world order throughout the whole period. The 1930s economic policy of the Nazi regime at home and abroad was recognized late and through the wrong lens. This is can be inferred from the fact that the criteria of successful economic development used under a regime of free trade – the export growth and terms of trade was still seen as the right measure of progress. In fact under bilateral clearing agreements export volume is not a good proxy for growth because it is disconnected from direct financial payments needed for investment. Germany offered terms of trade which are not beneficial to her but are beneficial to Bulgaria. It is utopian to expect that Germany would act as irrationally and against its interests. In fact Germany was selling to the non clearing countries on disadvantageous terms of trade by re-exporting the purchased raw materials from the clearing trade partners to the non clearing

⁷⁷ Ibid.

in exchange for convertible foreign exchange⁷⁸. This is actually another example of the importance of convertible currency.

Finally, the economic plan of minister Schacht can be seen as perverting the system of international lending, which Hirschman's analysis fails to recognize. Whereas in a free trade environment international credits run from the richer to the poorer countries the credit relations in this new arrangement were reverse – the poor country (Bulgaria) was financing the rich one (Germany)⁷⁹. This is as well evidence that the shift of international order is dramatic and the only basis for a positive expectation on the side of Bulgaria could have been an ethical claim. It becomes obvious in the following chapter that Bulgaria had little control over what is considered ethical.

The development of the “New Plan” on the other hand was a rational and systematic change of the existing international order. The official Nazi propaganda after the outbreak of the WWII “openly declared that the New Order will exist for the benefit of the German people, and that subject races must put up with a reduction in their standard of living” and “the lower race needs less food, less clothes and less culture than a high race”⁸⁰.

The self perception of being isolated from the general European utopia of securing peace in the inter-war period lead German foreign policy to a creative adaptation to the world. Germany did not believe in “a theoretical reconstruction of their continent”⁸¹ but had a utopia of its own – the utopia of the Nazi rule. It is a utopia in the sense it was built on the basis of aspiration and not history but it was pursued in a realist manner by

⁷⁸ Arndt, *The Economic Lessons...*

⁷⁹ Ibid.

⁸⁰ Ley 1940, cited in Paul Einzig, “Hitler's ‘New Order’ in Theory and Practice”, *The Economist Journal*, Vol. 51, No. 201, April 1941.

established power relations on the economic and later on the military level. It is in fact possible to act as an utopian and a realist at the same time only if you maintain the change of order desired. For the inter-war period Germany succeeded to establish its understanding of order. And this is precisely what Carr defines as the crisis – the “universal” belief that there should be no war in Europe proved utopian because in fact it was not universal. Germany in particular aspired a different idea and came into a position to defend it. This does not give us a simple tool for distinguishing between good and bad utopias and from enabling and disabling perceptions. Both utopian and realist extremes are dysfunctional for understanding international relations. In this sense Carr manages to offer yet another way of thinking about theory. I have so far tried to apply his framework to foreign policy as if foreign policy was the result of theoretical reasoning.

⁸¹ Stated by the Hamburg radio in November 8, 1940 (in Enzig 1941 p. 3)

Chapter 3. Mechanisms and effects of the clearing agreements between Germany and Bulgaria

The following chapter provides a detailed illustration of monetary dependence. It builds on both Hirschman's and Kirshenr's theories of dependence of a small, agricultural and poorer country to a big, industrial and richer one. Evidence of the transformation of trade dependence to monetary dependence is provided while explaining the mechanisms and effects of the clearing trade regime. It presents the transition from a free trade regime to a regime of predominantly bilateral and controlled trade as a rather cumulative process of dependency formation. The historical development does not switch from free trade or a full autarky but rather fluctuates towards different degrees of the two⁸². The proposed indicator tracing this fluctuation is the role of money. While the consequences of the Great War and the Great depression made room for economic nationalism, isolationist policies and state control over most activities and resources they also resulted in severe compromises with individual freedom. Money lost its meaning of "currency"⁸³ – it was used predominantly as a unit of account and not so much as a means of exchange.

3.1. Chronological review

3.1.1. *Bulgarian – German trade in the 1920s*

The inter-war economic relations between Germany and Bulgaria can be chronologically traced in two consecutive periods – the period of the 1920s until the Great depression and the period after 1931 when the exchange control and the clearing

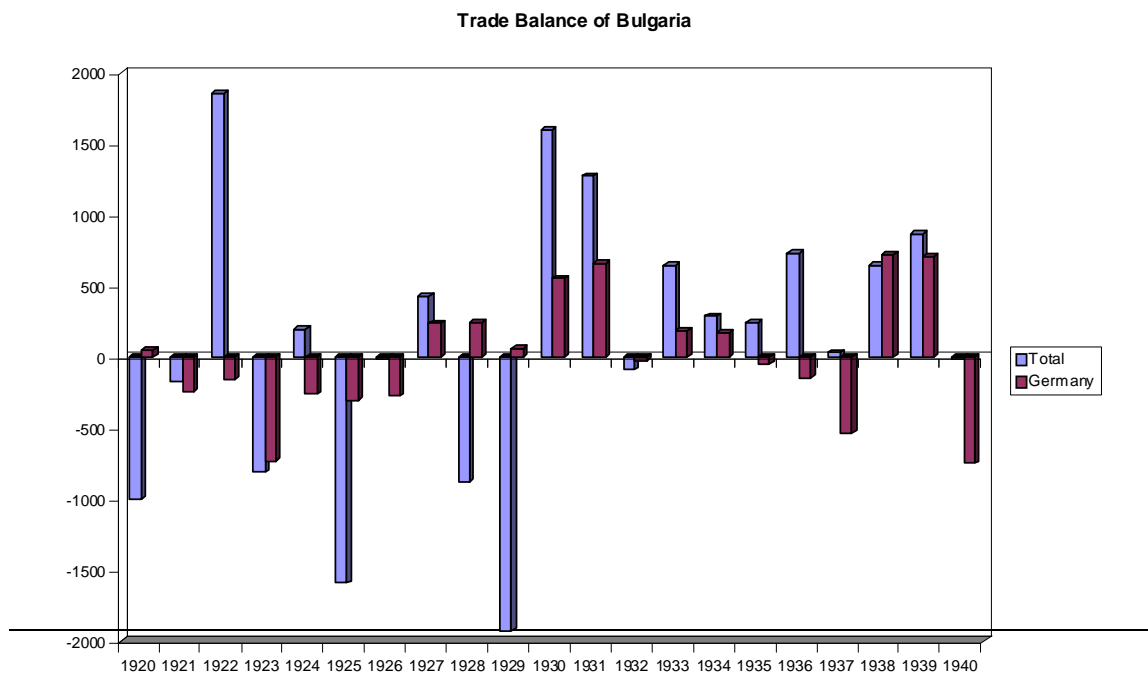
⁸² Robert B. Bryce, "Basic Issues in Postwar International Economic Relations", *The American Economic Review*, Vol. 32, No. 1, Part 2, March 1942.

⁸³ The etymology of currency is the Latin *currentum* - "to run", source: <http://www.etymonline.com/> The money used as a unit of account for the clearing agreements is called "Speermakrs" – blocked marks, also referred to as frozen.

agreements were established until the beginning of the 1940's. A detailed chronological analysis of the Bulgarian – German trade relations in this period, provided by Liuben Berov⁸⁴ is one of the most comprehensive sources on the Bulgarian perspective of the issue. It is widely supported by statistical data, which I will frequently referred to.

During the inter-war period Germany was one of the main trading partners of Bulgaria. The first decade of this time frame was characterized by economic stabilization of both countries and their relatively free trade relations based on the pre-WWI trade agreements between them. In the beginning of the 1920s the imports from Germany to Bulgaria accounted for an average of 20 per cent of the total imports to Bulgaria and the trade balance of Germany with Bulgaria changed from a negative of 20m. leva in 1919 to a positive of 729m leva in 1923⁸⁵.

Figure 1. Trade balance of Bulgaria with Germany and in Total⁸⁶.



⁸⁴ Liuben Berov, "Bulgarian-German trade relations in the interwar period", in Georgi Markov (ed.), *Bulgarian-German relations Volume II*, (Bulgarian Academy of Science, 1979) (in Bulgarian).

⁸⁵ Ibid., 295

⁸⁶ Ibid., 299, Table 1.

One of the factors for this increase in the twenties was the availability of short term crediting of foreign trade provided by the German manufacturing and trade companies to the Bulgarian importers⁸⁷. These credits usually service consignment contracts for agricultural machines but also import of cables, chemicals, etc. Another factor of the increase in German exports to Bulgaria was the devalued Deutsche Mark, which made the German exports cheaper compared to other exports on the world market⁸⁸.

On the contrary the Bulgarian exports to Germany – mainly raw materials and foodstuffs in particular tobacco and eggs, suffered a harder negative effect of the war and managed to reach the prewar levels of production only in 1926. The export of tobacco, already establishing itself as a main commodity, was mostly managed by French, Belgian, Dutch and Italian companies and their branches in Bulgaria. These exports were oriented towards countries with stable currencies. The German hyperinflation of 1923 and the undervalued Mark hurt some Bulgarian tobacco exporting companies selling to Germany. They were almost brought to bankruptcy which deterred others from engaging with the German market⁸⁹.

The stabilization of the Deutsche Mark in 1924 and the improvement of the railway system have a positive effect on the Bulgarian export. Crediting the Bulgarian importers of German goods was the main mechanism of export promotion used⁹⁰. Various foreign trade intermediaries and agencies were established for extending the trade with Bulgaria, cartel agreements between German and French companies were concluded in

⁸⁷ Ibid., 299

⁸⁸ Ibid., 300

⁸⁹ Ibid., 301

order to segment the market. For example the agreement between the German AEG and the French Compagnie Général Électrique assigned the Bulgarian market to AEG. The German expansion in the 1920s was perceived as harmful to local industrial capital and to the French investments in the whole Southeast European region⁹¹.

In 1921 Bulgaria and Germany signed an agreement of most favored nation treatment. Until then the bilateral trade was based on the agreements of 1905 and 1908, which were extended several times⁹². The 1921 agreement established new much higher custom taxes, which partly changed the export structure but did not prevent from increasing the German exports to Bulgaria. As a percent of the price of imported goods the size of the customs taxes raised from the range of 4 to 57 per cent in 1922 to a range of 5 to 97 per cent in 1926 following a protectionist differentiation⁹³.

In the 1920s the foreign exchange regime under which the German – Bulgarian trade was facilitated was still based on a free movement of foreign exchange even though the exchange rate was subject to the monopoly of the central bank. Bulgarian National Bank facilitated all international payments through its correspondent accounts in five big German banks – Deutschebank, Kommerz und Privatbank, Discotnogesellschaft, Dresdnrebank and Norddeutschebank. Under all these circumstances the balance of payments of Bulgaria with Germany was predominantly negative during the twenties – the German exports to Bulgaria surpassing the Bulgarian exports to Germany⁹⁴.

⁹⁰ Ibid.

⁹¹ Ibid., 303

⁹² Ibid.

⁹³ Ibid., 304

⁹⁴ Ibid., 299

3.1.2. Bulgarian – German trade in the 1930s

The second half of the inter-war period begins with the 1929-33 economic depression. Two factors of the depression proved crucial for the development of closer economic relations between the two countries – the general collapse of prices for agricultural goods and the abrupt decline of the German exports to Bulgaria. The collapse of the prices of agricultural products drastically diminished the monetary value of exports of Bulgaria but to a lesser extent and it affects the monetary estimation (the physical volumes do not decrease considerably⁹⁵). Due to the disproportionately bigger decline of imports from Germany Bulgaria accumulated a considerable trade surplus in the first two years of the great depression (600 million at the end of 1931⁹⁶). The free transfers of these assets were impossible after Germany introduced the foreign exchange control in 1931. At the same time 350 m. blocked German marks were accumulated in Bulgaria mainly due to the credited imports from German companies⁹⁷. In fact the reason for Germany to introduce the clearing agreements was first⁹⁸ to enforce payment of accumulated commercial debts to her exporters by the exchange control countries of South Eastern Europe” and was rather a financial than a commercial mechanism⁹⁹. The Great depression interrupted the normal flows of goods and payments between the countries. The financial crisis of 1931 and the huge capital outflow from Germany “invited” the imposition of exchange control a stabilization measure. For similar reasons exchange control was introduced in Bulgaria in December 1923 when the Bulgarian National Bank (BNB)

⁹⁵ Ibid., 305

⁹⁶ Ibid.

⁹⁷ Ibid.

⁹⁸ Ibid.

⁹⁹ Arndt, Economic Lessons...1944

assumed the monopoly on foreign exchange¹⁰⁰. The efforts to improve the negative balance of payments position of Bulgaria were still unsuccessful in 1926. The balance position was changed to a positive one as a result of the clearing agreements.

3. 3. The structure of clearing agreements

3.3. 1. The initial clearing agreement

The first clearing agreement was concluded in the spring of 1932 between the Bulgarian National Bank and the Reichsbank with the active involvement of the German tobacco concern Reemstma¹⁰¹. The aim of the agreement was initially to enforce payments to German exporters whose revenues were blocked in Bulgarian bank accounts¹⁰². The agreement was the following: Reemstma bought tobacco from Bulgaria for 50 m. levs while at least 25 per cent of this sum was to be spent on future German exports to Bulgaria and the rest 75 per cent covered the payments of old German claims¹⁰³. The clearing sums from the Bulgarian side were transferred to the Kreditbank, Sofia¹⁰⁴.

The transformation of the methods of payment in foreign trade spread gradually. In May 1932 negotiations for increasing the sum of the clearing to 200 m. levs failed and in July it was increased only to 100m¹⁰⁵. Eventually the amount was increased to 250 m. in August 1932 because all German claims were already balanced out¹⁰⁶. At the same time Bulgarian National Bank and Reichsbank negotiated concluding a general clearing agreement regulating the payments between the two countries. Under this agreement (concluded in September 1932) all payments between Bulgaria and Germany should be

¹⁰⁰ Nenovsky, Pavaneli, Dimitrova, Exchange Rate Control...

¹⁰¹ Liuben Berov, Bulgarian-German Trade...,306

¹⁰² Ibid., 306

¹⁰³ Ibid., 307

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

transferred to a current account between Bulgarian National Bank and Reichsbank in the framework of the foreign exchange regulation of each country¹⁰⁷.

Bulgaria concluded clearing agreements also with Czechoslovakia (1932), Austria, Switzerland, Belgium, Poland, France, Yugoslavia and Hungary (1933), with Turkey, Spain and Italy in 1934, with Holland in 1935. By the end of 1935 almost 80 per cent of Bulgarian foreign trade was concluded under clearing agreements, which is the biggest share of clearing trade among all the states in the exchange control bloc¹⁰⁸. Although Germany's share was between 45 per cent and 70 per cent of the total clearing its role is greater than these numbers show because Germany was the clearing center for all the bilateral agreements Bulgaria concluded and it controlled effectively their bilateral trade.

3.3.2. The Big Tobacco Compensatory Deal of 1934

One compensatory agreement of 1934 was a key symptom of the power maximizing behavior of the core state and the importance of the asymmetrical distribution of trade effects. "The big tobacco compensatory deal" as it is referred to is a result of the need for Bulgarian tobacco dealers to export the accumulated in the years of the depression big quantities of tobacco¹⁰⁹. The main task was to find placement for the old stocks of tobacco, some with deteriorated quality already, to a number of tobacco concerns in different countries – Czechoslovakia, Hungary, Austria, Poland, Germany¹¹⁰. After problematic negotiations on 31 of August the compensatory deal was signed with German, Czechoslovak, Austrian and Hungarian companies which were to deliver to

¹⁰⁶ Ibid.

¹⁰⁷ Ibid

¹⁰⁸ Svrakov, 1941 in Nenovsky, Pavaneli, Dimitrova

¹⁰⁹ Liuben Berov, "The 1934 Compensatory Tobacco Deal", in Georgi Markov (ed.), *Bulgarian-German relations Volume II*, (Bulgarian Academy of Science, 1979) (in Bulgarian).

¹¹⁰ Ibid. 323

Bulgaria trains, locomotives, railways, trams and other transport equipment¹¹¹. Germany had the biggest share of these deliveries equal to 631m leva out of total 910 m leva¹¹².

The Bulgarian government would pay this amount in five equal sales of tobacco¹¹³. The delivering companies received Bulgarian government bonds for 909 950 000 with 6 per cent annual interest and were to use those bonds for settling their payments on tobacco purchases from Bulgarian dealers¹¹⁴. The tobacco dealers then would use this bond to pay their taxes or could liquidate them at the central bank for a certain discount (Berov, 1979)¹¹⁵. The payments on the compensatory deal were originally intended to settle outside of the existing general clearing accounts between the two central banks but its final version does not include such a clause as a result of German pressure¹¹⁶. The deal was also not explicitly excluded from the annual quotas of tobacco exports negotiated¹¹⁷. As a result the total export of tobacco did not increase as much as the Bulgarian dealers would prefer. The increase of tobacco export price was negligible in contrast to the total increase of export prices¹¹⁸.

The payment mechanism of the compensatory tobacco deal is important as an illustration of yet another way of financing own exports leaving no safeguard mechanism for exercising control on the other party's adherence to the contract. It also demonstrates that again Germany was the only country able to buy the Bulgarian products at relatively

¹¹¹ Ibid. 323

¹¹² Ibid. 323

¹¹³ Ibid. 323

¹¹⁴ Ibid. 326

¹¹⁵ The compensation deal is an interesting example of state bargaining position against a private but state controlled foreign company, which is not analyzed here.

¹¹⁶ Berov, The Big Compensatory Deal. ,330

¹¹⁷ Ibid.

¹¹⁸ Ibid.

beneficial prices, which helped her, secure its power position regarding the terms of the contract. This is to a great deal due to the low quality and cost intensive production.

3.2. Clearing trade as concentration of power

The position of high dependence on clearing trade is another aspect of the trade dependence between Germany and Bulgaria. It is the inability to exit the bilateral relation that creates the dependence. The effectiveness of the clearing mechanism was recognized and exploited to a great extent by the Nazi government. For the period of the 1930s “65 percent of Germany’s foreign trade was based on the system of clearing... and 80 per cent was based on a bilateral basis”¹¹⁹. Nevertheless, clearing was not invented by the bureaucracy, it was recognized and advanced by it. It started as a bilateral form of trade used first by the private traders themselves in 1932 and 1933¹²⁰. This bilateral form of trade, called - private compensation agreement meant “importers needed to find exporters who could provide them with foreign exchange claims so that they get a permission to import.¹²¹” (Neal, 1979) Due to the overvalued mark the importer paid a premium to the exporter equal to the difference between the world price and the German price of exports¹²². After the exporter concludes the foreign trade deal, the foreign exchange is sold to the importer¹²³. The mechanism operated only “on a limited scale and excessively clumsy”, therefore “the government concluded general compensation or clearing

¹¹⁹ Arndt, Economic Lessons..., 187

¹²⁰ Ibid.

¹²¹ Lary, Neal, The Economics and Finance..., 398

¹²² Ibid.

¹²³ Ibid.

agreements with whole countries¹²⁴, (Arndt, 1944). The aggregated approach to trade is in fact what created the problem of “uncleared balance”. In Arndt’s words:

“Whereas private traders would embark on a barter deal only after they had made certain that the complementary orders had been placed and payments arranged, there was no certainty that the total trade between two countries would automatically balance.”¹²⁵,

In 1935 the Export institute was established in Bulgaria with a main function of controlling the export and standardize the export goods and materials and to direct the export to countries which offer the most beneficial terms¹²⁶.

Table1. Clearing and non-clearing trade of Bulgaria

Years/shares	Export (shares, %)				Import (shares, %)			
	Clearing in total export	Germany in total export	Germany in total clearing	Non-clearing in total export	Clearing in total import	Germany in total import	Germany in total clearing	Non-clearing in total import
1934	78.97	48.05	60.84	21.03	78.3	48.87	62.43	21.7
1935	77.25	49.48	68.09	22.75	80.19	59.82	75.11	19.81
1936	69.44	50.53	72.78	30.56	81.7	66.67	81.58	18.3
1937	65.52	47.11	71.91	34.48	79.9	58.22	72.82	20.1
1938	77.24	58.86	76.21	22.76	74.02	51.43	70.22	25.98
1938a	71.68	51.49	71.78	21.4	74.74	54.1	72.38	25.32
1939a	72.81	59.43	81.63	27.19	80.89	61.04	75.46	19.05

Note and source: a – export/import data refer to the first five/four months of the year.

Christophoroff, A. (1939) “The course of the trade cycle in Bulgaria 1934-1939”.

The exchange rate of the lev was fixed to the RM at 32.5 and later at 35 leva for 1 Reichsmark (RM) while the value of the RM on the international market was much lower¹²⁷. Despite the overvalued RM another negative factor of the agreement was that the blocked Bulgarian claims against Germany, accumulated before 1932 figured in a different blocked account of Bulgarian National Bank at the Reichsbank. 20 per cent of these assets were liquidated and transferred to “normal” accounts and the remaining 80

¹²⁴ Arndt, Economic Lessons..., 188

¹²⁵ Ibid.

¹²⁶ Liudmila Jivkova, 380

¹²⁷ Berov, Bulgarian German..., 307.

per cent were to be used for compensation of German claims against Bulgaria or spent on German goods¹²⁸. In fact Germany did not adhere to the agreement and the compensations of Bulgarian claims were not immediate and the old blocked claims of the exporters were cleared with a very long delay¹²⁹. In 1933 Reichsbank and BNB agreed that the blocked Bulgarian RMs could be used for covering the expenses of German tourists in Bulgaria.

In 1933 an annex to the clearing agreement was signed stipulating that 30 per cent of the value of Bulgarian export will be transferred to a special “free account” (freies Konto) at the Reichsbank¹³⁰. This account will be used for paying the German exports to Bulgaria of goods and industrial raw materials, which Germany also imports and pays for in free convertible currency¹³¹. These materials included cotton, wool, copper, lead, zinc, steal, leather, rubber, cast iron, tin. The deliveries under this account both in terms of value and kind of goods were to be negotiated twice a year between the Reichsbank and the Bulgarian National Bank, which further distributed the goods among the Bulgarian industrial enterprises¹³². The enterprises were on the other hand obliged to pay 20 per cent premium of the price of these goods and materials or to export in exchange of hard currency a certain type of goods which were less vital for Germany but also more difficult to export¹³³.

Berov’s research based on the archives of the Bulgarian National Bank finds that the Reichsbank did not fulfill its obligation and transferred less than the negotiated 30 per cent worth of the Bulgarian exports to the free account. The difference between the actual

¹²⁸ Ibid.

¹²⁹ Ibid.

¹³⁰ Ibid.

¹³¹ Ibid.

¹³² Ibid.

¹³³ Ibid.

and the due amount (shown bellow) was compensated with state deliveries from the War ministry and 400 m levs worth of foreign exchange which were transferred only in 1938 with the intermediation of a Swiss bank¹³⁴.

Table 2. Clearing trade of Bulgaria

The Free account balance			
Year	Bulgarian Export	Amount transferred to the free account	Amount due (30% of exports)
1936	1976 m. leva	208 m. leva (14%)	592 m. leva
1937	2364 m. leva	358 m. leva (15%)	709 m. leva
1938	3284 m. leva	302 m. leva (9%)	985 m. leva

Source: Berov, 1979.

Another occasion when Reichsbank allowed the transfer of convertible currency to Bulgaria was in 1937, the amount of 300 000 GBP were transferred to serve the needs of Bulgaria's freight payments on its shipped exports to Germany¹³⁵. These examples clearly demonstrate that the limitations Bulgaria had to put up with while being a diligent partner and supplier. It received the "payments" for its exports in a very illiquid form, too late and not according to the contract.

3. 3. Financing international trade under bilateral clearing

3. 3. 1 *The clearing house*

While clearing may seem a very convenient mechanism of exchange it is only so in the case of balanced trade, which is rarely the case. International trade is cleared through the central bank (clearing house or in German Verrechnungskasse) where the importer deposits domestic currency and the exporter gets paid for its export again in domestic currency. The settlement is done at an agreed exchange rate. In case of a trade surplus the country accumulates positive clearing balance (this was the case of Bulgaria and most southeast European partners of Germany). There are two ways of payment under clearing

¹³⁴ Ibid.

¹³⁵ Ibid.

– the waiting principle and the financing principle. Kirshner defines the two principles as follows:

“Under the waiting principle, exporters are only paid from the specific deposits of local importers. If imports are less than exporters at any given time, exporters must wait for a new import, so that the importer can make a deposit into the clearing account. ... This has a tendency to reduce liquidity even to create negative multipliers on the economy. The financing principle is followed when the exchange authorities ... pay domestic exporters with (domestic) currency created ... against payments to the blocked accounts by foreigners.”¹³⁶

Further in his analysis Kirshner mentions that the financing principle is much more efficient under the expectation of balanced trade. Bulgaria applied this principle in the expectation of offsetting exports from Germany and kept financing its own exports until the very end of the clearing system.

3.3. 2. *The Commercial Banks*

After the establishment of the exchange control the role of the private banks as financial intermediaries on foreign transactions was seriously limited. After signing the clearing agreements the Kreditbank, lead by Marco Riascoff (later a governor of central bank and a minister of finance of Bulgaria) facilitated a big part of the exchange with Germany mainly the imports from the Reich due to its good relations with the German banks¹³⁷. Riascoff's view (expressed in his memoir book, BNB, 2006) the possibilities for a considerable increase in the exchange with the richer countries having free foreign exchange were negligible. He also explains why neither the French nor the English engaged in a more extensive partnership with Bulgaria thus leaving it in the sphere of German control. Bulgaria had no way of paying for its imports unless it paid with exports – it had no gold, no foreign exchange, and no hard currency income. In his view the

French were not interested in buying Bulgarian goods, judging from the small quantities of exports to France, the English would buy even smaller quantities and offer their more sophisticated industrial goods were unsuitable for the needs of the Bulgarian customers¹³⁸. The Germans on the contrary adopted the policy of “buy in order to sell” so they took the burden of traveling across Bulgaria meeting companies and concluding trade contracts. He comments on the difficulty to export tobacco to Germany due to the high competition from Greek tobacco and the personal efforts – use of contacts, treatment of officials with the finest samples and assistance with Bulgarian bureaucracy. Despite the state monopoly over the economy, the currency and the transactions international commerce through a personal perspective seems to have retained its primary social character.

3. 4. The effects of bilateral clearing on the Bulgarian economy.

3. 4. 1. Monetary effects

The positive balance of Bulgaria together with implementation of the financing principle undertaken by the Bulgarian National Bank lead to an increase of the money in circulation, the price level, the income level and therefore the demand for imports. The monetary expansion, which was covered with Sperrmarks lead to an economic expansion. The price increase occurred as late as the end of 1933 beginning of 1934 (for the first time after the great depression). The inflation for the first three years of the economic recovery is minimal, about 2%, by 1937 it reaches 12.6% and continues to grow. This is contrary to the predominant deflationary trend of the world economy. Among the European countries

¹³⁶ Kieshner, 126.

¹³⁷ *Marco Riascoff Memoirs and Documents*, BNB, 2006 (in Bulgarian)

¹³⁸ This is an example of Hirshman’s theoretical proposition that export product diversification matters for dependency. Due to low diversification of foodstuffs the industrial countries can easily switch between different suppliers of food, on the contrary the diversification of industrial goods does not allow agricultural countries to easily change their supplier of machines. Hirschman, 1945, p.32.

only Bulgaria, Yugoslavia, Hungary and France¹³⁹ experience such an increase¹⁴⁰. The price index of Bulgarian export goods is continuously rising in the second half of the thirties, the price index of the imported goods remains relatively constant and the prices of local goods for domestic consumption show a clear devaluation tendency¹⁴¹.

In Christoforov's analysis the rise of the prices index is due to several factors all driven by the specific mechanisms of foreign trade – the increase of the quantity and speed of money circulation, the increase of the prices of export goods, the changes of the real exchange rate of the lev. But according to Christoforov the cause for price increase is rather the speed of monetary circulation than its volume.

Neal¹⁴² also acknowledges that the effect of monetary expansion was greater on employment than on prices. He explains the role of bilateral clearing agreements as a means of “financing the economic recovery”¹⁴³ of South - Eastern Europe. In his view, the countries that benefited the most in economic terms from the clearing agreements were Hungary and Bulgaria. To use them effectively, however, the trading partner had to run an export surplus with Germany and then have its central bank purchase the blocked Speermarks from its exporters. As Neal points out, the larger the export surplus and the higher the exchange rate of the Speermarks, the greater became the expansionary effects of the central bank¹⁴⁴.

¹³⁹ The reason for the French inflation is mainly the devaluation of the currency.

¹⁴⁰ See A. Christoforoff, “The Course of the Trade Cycle in Bulgaria 1934-1939”, Statistical Institute for Economic Research, State University of Sofia. (in Bulgarian)

¹⁴¹ Ibid.

¹⁴² Lary Neal, “The Economic and Finance of Bilateral Clearing Agreements: Germany, 1934-8”, *The Economic History Review*, Vol. 32, No. 3, (Aug. 1979).

¹⁴³ Ibid, 393.

¹⁴⁴ Ibid.

On the contrary, the waiting principle allows for devaluation of the Speermark which has a negative effect on the income of exporters. Such policy was pursued by Romania and Yugoslavia, where the Speermark was let to depreciate. Bulgaria was the only country, which kept the original exchange rate to the Speermark¹⁴⁵.

Table 4. Bulgarian National Bank balance sheet from 1928 – 1940 (mill. levs)

Assets	1928	1930	1932	1934	1936	1938	1940
Gold and silver holdings ¹	1598	1879	1874	1900	2049	2586	2301
Receivables in gold foreign currencies (article 10 of BNB Law)	2736	481	92	26	0	0	4
Other foreign currencies	534	152	116	174	772	1279	2336
Domestic credit ²	5362	4267	3913	3724	4336	4829	8021
Treasury bonds	0	0	130	310	0	0	0
Other items ³	164	375	247	252	215	146	557
Total assets	10394	7154	6373	6386	7372	8839	13219
Liabilities							
Capital	500	500	500	500	500	500	500
Reserve funds	1149	1169	1191	1240	1241	1188	1207
Banknotes in circulation	4173	3296	2635	2449	2571	2800	6518
Deposits ⁴	3862	1817	1813	1872	2382	3707	3785
Other liabilities ⁵	637	287	203	277	546	443	937
Profit	71	83	32	48	133	202	272
Total liabilities	10393	7154	6373	6386	7372	8839	13219

Note and source: ¹. Gold and silver holdings including gold and silver coins at cash. ². Domestic credit comprises of receivables from the government, banks, commercial papers and effects. ³. Real estates and other assets. ⁴. Demand, time and other deposits of government and banks. ⁵. Liabilities in gold and other foreign currencies. Original balance sheet data from BULGARIAN NATIONAL BANK (2001) 120 Years Bulgarian National Bank, p. 130.

The item “other foreign currencies” on the assets side of the balance sheet includes the foreign non-gold backed currency received from the clearing and compensation agreements. The financing principle was a mechanism of lending to Germany¹⁴⁶. In Berov’s analysis of the effects of the clearing agreement we read

¹⁴⁵ See Nenovsky, Pavaneli, Dimitrova, Exchange Rate Control...

¹⁴⁶ Ibid.

the biggest part of the high quality Bulgarian export items were directed to Germany but Bulgaria was no longer able to use the acquired German currency for buying the needed foreign industrial raw materials (deficient for Germany itself) from the world market. Bulgaria ended up to a great extent with tied hands¹⁴⁷.

3.4. 2. *The terms of trade debate*

The terms of trade of Germany are discussed both as means and ends to foreign economic policy. The debate reveals an important aspect of the power relationship and the dependency formation. It is widely accepted fact that Germany offered terms of trade favorable to the small countries paying more for its imports than the level of world prices even though it had a monopoly position of the main and sometimes. This is seen as the “carrot” which the Nazi regime offered to its southeast European partners in order to “entrap” them into a predatory kind of trade relation. After this initial step however Germany “managed to reduce the costs of bilateralism to a minimum and improve her terms of trade considerably”¹⁴⁸ because of its position of discriminatory monopoly.

Unfavorable terms of trade on the other hand are often recognized as the negative result of the unfair trade Germany concluded with its partners. Benham discusses the theoretical relationship between favorable terms of trade and a nation’s net gain from trade¹⁴⁹. He does not believe that terms of trade can be used as a straightforward “measure of the division of the gains form trade between two countries” and the theoretical simplification of using two countries and two commodities “has done a good deal of damage”¹⁵⁰. As long as the terms of trade ratio refers only to the prices of things that a country sells to the prices of the things it buys, it is not in itself an end but rather a means

¹⁴⁷ Liuben Berov, “Bulgarian-German trade relations...”, 303.

¹⁴⁸ Frederic Benham, “The Terms of Trade”, *Economica*, New Series, Vol. 7, No. 28, November, 1940., 362.

¹⁴⁹ Benham, “The Terms of Trade”.

¹⁵⁰ Ibid, 362.

to achieving broader economic policy goals¹⁵¹. Very often good terms of trade are a part of an unfavorable economic situation as a whole. Germany was not trying to improve its terms of trade with the Southeast European countries but offered more favorable terms of trade because it aimed to divert the trade of those countries towards itself. The better terms of trade do not however mean a better overall economic situation. The implication of Benahm's argument is that Germany while deteriorating its terms of trade experiences positive overall economic development while, the countries in southeast Europe, while improving their terms of trade led them into a disadvantageous position of dependency.

Lary Neal¹⁵² gives a more specific interpretation of the terms of trade of Germany – he sees them as a sign of the rapid growth of the German economy (11 per cent annually for the period 1934-8) and improving efficiency. According to him “when trade is carried out under conditions of rapid growth, falling terms of trade indicate that a country is increasing its productivity more rapidly than its trading partners¹⁵³.” He also acknowledges the “serious theoretical problems in measuring terms of trade under conditions of bilateral clearing agreements”. The currencies kept in the blocked accounts are not a proper unit of account, they are a form of “funny money “ and do not represent prices obtained under competitive conditions of trade. On the other hand he also looks into the broader economic conditions in the beginning of the 1930s and recognizes the need of the Southeast European countries the “reflate” their economies. The only option for doing so was the bilateral clearing agreements. Not the terms of trade as such but rather the way these terms of trade were exploited as a financing instrument determined the net benefits

¹⁵¹ Ibid, 365.

¹⁵² Neal cites Benham's analysis of the German terms of trade as “the earliest authoritative study of the empirical data”.

or losses for the countries. In his analysis the central bank policy is directly related to the pace of economic recovery.

Neal reviews the debate on German terms of trade as advanced by Ellis, Benham, Einzig, and Kindleberger. Analyzing Ellis, Neal concludes that the German import prices rise faster than the export prices, which means that German terms of trade deteriorate. He confirms this finding in Benham's work. Paul Einzig strongly opposes the validity of these results on the grounds of unreliable data and apolitical propaganda.¹⁵⁴ Kindleberger (in support of Benham) finds that "Germany's terms of trade with non-industrial Europe increased less than they did with any other trading region"¹⁵⁵.

Nevertheless the monopoly-monopsony framework of analysis proves inadequate for understanding the complex structure of mechanisms motivations and effects of bilateral pricing. In general the prices under clearing form of trade are higher than the free market prices. While these debates examine predominantly the German terms of trade and the effects on the German economy, the same debate about the Bulgarian terms of trade is provided in the Bulgarian literature. Christoforov analyses the dynamic of prices for the agricultural and industrial products and the related to them change in the real wages of the peasants and workers (and a certain social imbalance)¹⁵⁶. He describes a steady upward trend of the agricultural prices throughout the period 1934 – 8 and a much more volatile behavior of the local industrial goods¹⁵⁷. His review of the price levels and terms of trade does not comment on the influence they have on the broader economic development

¹⁵³ Neal, *The Economics and Finance...*, 393

¹⁵⁴ Ibid.

¹⁵⁵ Ibid.

¹⁵⁶ A. Christoforoff, "The Course of the Trade Cycle in Bulgaria 1934-1939", Statistical Institute for Economic Research, State University of Sofia. (in Bulgarian)

¹⁵⁷ Ibid.

except for the dynamic of the real wages¹⁵⁸. Based on the available data (which is very insufficient) he points out the real wages fall continuously between 1934 and 1936 and then takes a slow upward trend. He brings a lot of data confirming that the export prices were exceeding the import prices.

On the contrary Berov claims that after the clearing agreement of 1932 was signed the terms of trade of Bulgaria deteriorated¹⁵⁹. This is valid for the average price, while individual types of goods were exchanged under different terms. The prices for which Bulgaria exported wheat to Germany in the thirties for example were considerably higher than the world prices for wheat (with 35 – 50 per cent) while the prices for the exported tobacco were much lower than the prices of tobacco when sold to other countries¹⁶⁰. In this respect the Nazi regime was using a simple trick – for the goods which it bought from Bulgaria in small amounts it offered very preferential clearing prices as part of the propaganda¹⁶¹. The goods, which it bought in big amounts and which took the leading export positions for Bulgaria, were exchanged at very disadvantageous for Bulgaria prices¹⁶². A similar position was held by Guillebaud who argued that “in large compensation transactions Germany was often able to secure a price for her exports well above the ordinary competition price.”¹⁶³ (in Neal , 1979, p). According to Berov after 1932 the average prices of Bulgarian exports were below the world prices and the average prices of the imports from Germany were above the world prices. He estimates that the Bulgarian economy suffered more than 1.5 bill. in PPP of 1939 which contributed to the

¹⁵⁹ Ibid.

¹⁶⁰ Ibid.

¹⁶¹ Ibid.

¹⁶² Ibid.

¹⁶³ in Lary Neal, Economics and Finance..., 394

drop in the real wage of the workers. On the other hand due to the overvaluation of the RM the Bulgarian agricultural exports (excluding tobacco) enjoyed better prices under the clearing agreement system and contributed to a nominal rise of the income of agricultural population. This effect was balanced by the high prices of the imported industrial goods and machines and in Berov's view the net effect was not an increase in the real income of Bulgaria's peasants and workers. He concludes that the role of the Bulgarian-German trade in the inter-war period cannot be easily determined as positive or negative, either characterization would be too one-sided and incomplete. The terms of trade debate reveals an important theoretical consideration about the applicability of standard economic criteria, developed for a free trade type of exchange, to the understanding of gains from trade under bilateral clearing.

3.4. 3. Trade effects

One of the highly debated issues about this form of trade is Bulgaria's satisfaction of preferences for the goods it imported. Some authors Einzig, Petzold believe that the German exports to Bulgaria were mainly luxury foods, toys, and products of a very low preference to the Bulgarian market. It is therefore important to briefly look into the structure of the German imports to Bulgaria. The main item of Bulgarian import from Germany was metals and metal products (about 1/3 of total imports) due to the lack of developed domestic metal industry¹⁶⁴. Machines and transport vehicles took equally important position, while the machines were used for the industry. The group of the vehicles consisted mainly of trains and wagons until the mid 1920s but later in the thirties

¹⁶⁴ Berov, The Bulgarian-German Trade..312

the import of automobiles increased together with that of bicycles and motorcycles¹⁶⁵. Considerable amounts of radios and telecommunication appliances, clocks etc. were imported at the end of the 1920s. The relative share of chemicals also rose from 1/20 to 1/10 of the total imports, half of which were medicines. Due to the development of the Bulgarian textile and clothing industry the import of clothing declined at the expense of import of textile materials. Nevertheless, the import of agrarian machines remained insufficient¹⁶⁶. The import of fertilizers was negligible (less than 2 m. levs per year). Similarly the import of oil and other fuels was also small. The import of toys, jewelry, perfumery as a percentage of total imports has actually declined in the inter-war period in comparison to the years before 1912¹⁶⁷. This is contrary to that claims that toys and other unimportant goods were the main imports from Germany. In Berov's words:

“Despite the negative attitude to the further industrialization of Bulgaria within the New Order the import from Germany played in fact a central role for the supply of Bulgaria's economy with the much needed technology and industrial raw materials until the WWII.”¹⁶⁸

One effect of the clearing agreement was the increase of import of paper, leather, chemicals, textile raw materials, which was due not to the competitiveness of Germany in producing those items but of actually eliminating its competitors by mechanisms of the bilateral agreements by freezing their accounts. Another reason was the multiple exchange rate system also due to the use of multiple exchange rates, not only for import and export but also for different goods under the preferential economic policy. Subsidies and other

¹⁶⁵ Ibid.

¹⁶⁶ Ibid.

¹⁶⁷ Ibid.

¹⁶⁸ Ibid. 312

instruments for boosting export as well as the premium paid on the overvalued Reichsmark obscure the information that prices give. Prices and their monetary expression have therefore lost their information function.

It is easier and somewhat more obvious to estimate the effects of the clearing trade on Bulgarian production and the structure of the Bulgarian exports to Germany. This issue is often discussed as evidential for the power Germany exercised in forcing its smaller trade partners to subject their economies to its needs. Bulgarian export structure changed considerably in the inter-war period.

Before the beginning of WWI the main exports of Bulgaria to Germany were grain and grain food which after the war gave way to the export of tobacco, eggs, fruits and vegetables and ores¹⁶⁹. The shift towards tobacco was stimulated by Germany pursuing a policy of autarky in the area of serials, milk and milk products and food supply in general¹⁷⁰. Its efforts to self sustain the food industry lead to a restrictive import policy regarding grapes, fresh fruit, vegetable and pork. Bulgaria had to find other markets for these products or to adjust its production to the needs of Germany as only 8-14% of Bulgarian export of wheat for example was exported to Germany. Another reason for tobacco becoming the main export item, not only to Germany but also of the Bulgarian economy as a whole, is the territorial loss of Dobrudzha (the grain field of Bulgaria) after WWI, which was only regained in 1940.

Table 5. Bulgarian export to Germany

¹⁶⁹ Ibid.

¹⁷⁰ Ibid.

Structure of the Bulgarian export to Germany in mill lev																
Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16 Total
1908	5.24	0.9	0.25	0.01					3.97			0.14		0.68	0.39	11.62
1912	5.44	0.92	0.25						11.34	0.1		1.01	0.15	4.42	0.94	24.53
1919			20													20
1924	69	4	600				1		129			35	1	7	15	866
1929	149	63	1000	11		1			389	12		123	6	55	86	1911
1934	12	33	663	108	28		1		180	16		38		16	6	2534
1939	161	181	1589	700	462	124		13	426	154	2	63	23	103	39	4110
1943	404	602	5383	235	2448	640	74	332	285	7		159	1000	752	149	12796

Legend: 1 – grain; 2 – oil yielding seeds, beans, vegetable seeds, herbs; 3- raw tobacco; 4-fresh fruit; 5 –tin fruit, jam; 6- alcohol and on-alcohol drinks; 7- fresh vegetables; 8 – tin vegetables; 9 – eggs; 10 – meat, live and slaughtered birds; 11 – tin meat; 12 – leather, fur; 13 – ores, coal, wood; 14 – industrial goods; 15 – waste materials, scrap; 16 – milk products; 17 – total

Source: Berov, 1979.

Hirshman's analysis of the big trade dependence of Bulgaria on Germany as a part of the general dependence of the other southeast European States by comparing the "concentration of imports to the concentration of exports". There is no considerable concentration of trade before 1932 and a strong concentration after the clearing system is introduced. The concentration of exports is bigger than the concentration of imports which in theory should mean less dependency and therefore a better off position. But as long as dependency is estimated on the share of trade actually concluded an important aspect of dependency remains out of scope. The exports from Germany to Bulgaria that have not been delivered constitute a crucial constraint to the economy. The lack of sufficient raw materials for the industry had actually hurt the production and transportation of the goods, which Germany was buying. The Situation becomes especially acute in 1939 and 1940 when Bulgaria voiced its claims against the German ministry to start paying for the supplies because it can no longer support its own exports and satisfy the German demands. Archive materials of the German foreign ministry support this claims and give a valuable feedback on the German perception of the trade with Bulgaria.

Two reports account for an extensive correspondence in 1939 after the signing of the second clearing agreement and later on in 1940 regarding the German negative balance with Bulgaria posing an urgent need for increasing the German supplies.

A 9 February 1940 report¹⁷¹ to the German Foreign Ministry stated that according to Tsonev (the head of the Bulgarian export – import institute) Germany is falling behind with the deliveries of goods to Bulgaria and also Damianov - the president of the Bulgarian society in Germany and himself the owner of a shipping company, speaks about the disadvantageous effects of the delays of the German deliveries. Dr Landwehr – the minister of the Economy (Reichwirtschaftsministerium) has confirmed that the Bulgarian credit at the German Clearing account (the Verrechnungskasse) is over 60 Million RM. The report further says that Bulgaria has exported extensively to Germany and even though it is a poor country, it has financed these exports by itself. Apart from the financial drawbacks, this financing has caused difficulties because the need to finance the exporters through new emissions of notes by the central bank puts the economy into the danger of inflation. To illustrate further the report says that the clearing credit of 60 Mill RM means that approximately each Bulgarian (6.5 million people at the time) has given Germany 10 RM. Along with providing the Bulgarian perspective, the report evaluates the role of Bulgaria is a very important supplier for Germany especially in the area of foodstuff supply. “Germany has already strongly influenced the production structure of the land and the Bulgarians have very strongly adjusted to the economic needs of Germany. Bulgaria trusts politically in its peasant population and expects therefore German help in developing its agricultural economy. All Balkan states know that Bulgaria is very strongly connected

¹⁷¹ Bundesarchiv R 43 II 1303.

to Germany and observe closely how exactly this connection is going to develop. For the Bulgarian civil servants it becomes ever more difficult to support the position of increasing the trade with Germany as they face harsh critique from the entrepreneurs who do not receive the goods they have ordered from Germany.” The report further stresses the capital insufficiency of the Bulgarian economy and the increasing difficulties it faces and stresses that the present situation “demands” Germany to pay for the Bulgarian deliveries. This can be achieved only through German deliveries to Bulgaria. The report recommends that: “the German side must fulfill the concluded contracts; it must be arranged that German supplies to Bulgaria become a privilege; Bulgaria cannot wait any longer for these supplies and because it is not economically possible to further self finance its exports. If the failure to supply keeps disturbing the Bulgarian economy, the result will be such that the Bulgarian farmers who do not receive their payments could start selling to other countries.” Another consequence of the German failure to supply will be that the other Balkan states will become more cautious in their trade relations with Germany and may deter from or decrease the scope of trade with the Reich. The conclusion of the report is that the German supplies to Bulgaria must increase because the present position can no longer be sustained without the described negative effects taking place. The reason why the German supplies to Bulgaria have not been delivered so far is that the German army had demanded and received all materials intended for export to the Bulgarian companies¹⁷².

The second report (from March the 7th 1940) provides evidence of the Bulgarian demands. Emphasizing the positive and mutually beneficial relations between the two countries the

¹⁷² A similar situation is reached in Yugoslavia where the awaited supplies of war materials were not realized.

Bulgarian side stresses that for the past few months the passive clearing account of Germany creates insurmountable difficulties. A letter from 6th of December 1939 to the German ministry of economy describes the situation in Bulgaria as very serious and demands a timely helping measure from the German side. The letter puts forward that “so far the Bulgarian supplies to Germany have never been interrupted or decreased in volume but is simply no longer possible to continue the exports if Germany does not start supplying the necessary goods and materials”. The Bulgarian National Bank is empowered by law to lend 2,2 billion Levs (66 Million RM) to the Bulgarian government for the purpose of buying different goods from Germany. The demands are for the following import items: war equipment for about 27 Mill. RM¹⁷³; Trains and railways for about 12 mill RM; Telephones for 20 mill. RM; trams for the city of Sofia (4 mill. RM); agricultural machines (10 mill. RM).

It is also extremely important for the Bulgarian side to receive about 20.000 t. concrete and steel and about 30.000t. strip steel and railway tracks. The importance of these supplies is both for the Bulgarian and for the German economy as these materials will be used for the production of agricultural raw materials, barrels; the railways to be built will also serve the numerous German trains connecting to the ports of the Black Sea. The urgency of the letter is increased with the statement that it becomes no longer possible to sustain the exports to Germany if the demanded materials are not supplied in return. The consequences of Germany failing to supply may be serious and “sad” as this will ultimately disable the trade between both countries and it is indeed in the interest of both parties to increase the German supplies to Bulgaria. The letter also expresses the belief that against

¹⁷³ Bulgaria starts its remilitarizing in 1934.

the background of the displeasing and undesirable consequences the present situation may have the Bulgarian demands are not so huge and will not seriously affect the German industry.

As a result in 1940 another clearing agreement is signed between Reichsbank and Bulgarian National Bank which excluded all private compensatory deals. A common institutional authority was established for the control of bilateral trade, economic and finances¹⁷⁴. Some authors as the achievement of full control over the foreign economic policy of Bulgaria consider the same year¹⁷⁵. After 1940 the monetary expansion induced inflation and a devaluation of the real exchange rate of the lev¹⁷⁶.

Conclusion

Approaching the international monetary relations from the point of view of monetary power provides a valuable understanding of the mechanisms of coercion in the field of international monetary relations. It is above all the effect of entrapment that

¹⁷⁴ David Koen, "Germany and the Bulgarian Industry during the World War II", in Georgi Markov (ed.), *Bulgarian-German relations Volume IV*, (Bulgarian Academy of Science, 1979) (in Bulgarian).

monetary dependency pursues because it is an invisible form of coercion. Entrapment secures a shift from the shift of interests in the target country which makes its foreign economic policy preferences in harmony with the interests of the home state.

The mechanism of limiting foreign exchange at international trade transaction is crucial to achieving entrapment and exercising coercion. It is a form of power that can be exercised by the government without causing social disturbance as its effects are dispersed and difficult to trace back to the causes.

Studying the international monetary relations in historical perspectives gives us valuable examples of monetary power in practice. It also poses a number of challenges. There seems of yet not to have been determined a proper tool of measuring the effects of monetary dependence. This difficulty arises from the distorted meaning of money and monetary price that the dependency relationship may cause.

There are a number of areas where the analysis can be applied to. While it is a history-based theory, it always proves right by the examples it uses but also raises a number of other issues. It could develop in the areas of international exchange rate bargaining where history of monetary reputation can be advanced. Finally this theory advances the research of invisible effects of visible actions which while extremely important, is both interesting and exciting.

Bibliography

Arndt, H.W. *The Economic Lessons of the Nineteen-Thirties*. London: Frank Cass, 1972, [1944].

Auswärtiges Amt
BA, R 43 II. 1303b

¹⁷⁵ Ibid.

¹⁷⁶ Ibid., 499

BA, R 901, 68433

BA, R901 60640

Balogh, T. "Foreign Exchange and Export Trade Policy". *The Economic Journal*, Vol. 50, No. 197, March 1940.

Balogh, T. "The Drift towards a Rational Foreign Exchange Policy". *Economica*, New Series, Vol. 27, August 1940.

Balogh, T. "The National Economy of Germany". *The Economic Journal*, Vol. 48, No. 191, September 1938.

Benham, Frederic. "The Terms of Trade". *Economica*, New Series, Vol. 7, No. 28, November, 1940.

Berend, Ivan T. "The Failure of Economic Nationalism: Central and Eastern Europe before World War II". *Revue economique*, Vol. 51, No. 2, March 2000.

Berov, Liuben. "Bulgarian-German trade relations in the interwar period". In *Bulgarian-German relations Volume II*, edited by Georgi Markov. Bulgarian Academy of Science, 1979. (in Bulgarian)

Berov, Liuben. "The 1934 Compensatory Tobacco Deal". In *Bulgarian-German relations Volume II*, edited by Georgi Markov. Bulgarian Academy of Science, 1979. (in Bulgarian)

Bryce, Robert B. "Basic Issues in Postwar International Economic Relations". *The American Economic Review*, Vol. 32, No. 1, Part 2, March 1942.

Bundesarchiv, Berlin

Carr, E.H. *The Twenty Years Crisis 1919-1939: An Introduction to the study of International Relations*. London: Macmillan, 1983 [1939].

Carr, E.H., *International relations between the two world wars, 1919-1939*, (London: Mc Millan 1990 [1947])

Chief of Counsel For Prosecution

Christoforoff, A. "The Course of the Trade Cycle in Bulgaria 1934-1939". Statistical Institute for Economic Research, State University of Sofia. (in Bulgarian)

Cohen, Benjamin. *The Future of Money*. Princeton: Princeton University Press, 2004.

Cox, Robert. *Approaches to World Order*. Cambridge: Cambridge University Press, 1996.

Einzig, Paul. "Hitler's 'New Order' in Theory and Practice". *The Economist Journal*, Vol. 51, No. 201, April 1941.

Fisher, Allan G. B. "The German Trade Drive in Southeastern Europe". *International Affairs (Royal Institute of International Affairs 1931-1939)*, Vol. 18, No. 2, March-April 1939.

Foreman-Peck, James. *A history of the World Economy: International Economic Relations since 1850*. Harvester Wheatsheaf, 1983.

Hardach, Karl. *The Political Economy of Germany in the Twentieth Century*. California: University of California Press, 1980 [1976].

Hayek, F.A. *Economic Freedom*. Basil Blackwell, 1991.

Hayek, F.A. *The road to Serfdom*. London: Routledge, 1991 [1944].

Heilperin, Michael. *Control of International Trade*. (London: Routledge, 1939)

Hidden, J. *The Baltic States and Ostpolitik* (Cambridge University Press, 1987).

Jivkova, Liudmila. "German Economic Expansion to Bulgaria (1933-1939)". In *Bulgarian-German relations Volume I*, edited by Georgi Markov. Bulgarian Academy of Science, 1979. (in Bulgarian)

Kaser, M. C. and Radice, E.A. (eds.). *The Economic History of Eastern Europe 1919-1975. Volume II Interwar Policy: The War and Reconstruction*. Oxford: Oxford University Press, 1986.

Kirshner, Jonathan *Currency and Coercion: The political economy of International Monetary Power*. Princeton: Princeton University Press, 1995.

Kitchen, M. *The Political Economy of Germany 1815 – 1914*, (London, 1978).

Koen, David. "Germany and the Bulgarian Industry during the World War II". In *Bulgarian-German relations Volume IV*, edited by Georgi Markov. Bulgarian Academy of Science, 1979. (in Bulgarian)

League of Nations Report on Exchange Control, submitted by a Committee composed of Members of the Economic and the Financial Committees. Geneva, July 9, 1938.

Markov, Georgi, *Bulgarian-German Relations 1931–1939*, Bulgarian Academy of Sciences, Institute of History, Sofia: 1984.

Nazi Conspiracy & Aggression, Volume Two, Chapter XIV, Individual Responsibility of Defendants; Hjalmar Schacht.

Nenovsky, Nikolay, G. Pavaneli, K., Dimitrova, "Exchange Rate Control in Italy and Bulgaria in the Interwar Period. History and Perspective", Southeast Europe Monetary History Network Viena, 2007 forthcoming. New Series, Vol. 54, No. 2, May, 2001.

Overy, R. J. *War and Economy in the Third Reich*. Oxford: Oxford University Press, 1994.

Petzold, Joachim Zur Kontinuität der Balkanpolitik des Deutschen Imperialismus in Bulgarian- German Relations and Ties, Vol.2, Bulgarian Academy of Sciences. (1979)
Reichwirtschaftsministerium: Ministry of Economy of Reich

Ritschl, A. O. "Nazi Economic Imperialism and the Exploitation of the Small: Evidence from Germany's Secret Foreign Exchange Balances, 1938-1940". *The Economic History Review*,

United States Government Printing Office
Washington * 1946