MONETARY CRISIS IN THE 30TH AND THE REACTIONS OF BULGARIAN ECONOMISTS*

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Summary

In the paper, I deal with the issues of how the Bulgarian academic community interpreted the monetary crisis (especially pound devaluation) and in what theoretical models Bulgarian economists thought and practical solutions they offered during the Great Depression.

Key words: Bulgarian economic thought, Great Depression

JEL codes: B 10, B 20, B30, N13, N14, G01

The decisive phase of the Great Depression period was the banking crisis in Austria and Germany, which led to a currency crisis of the sterling pound and its devaluation in the summer of 1931, and of the dollar in early 1934. The crises of those two main currencies began to bear directly on Bulgaria and thus became the subject of numerous analyses (Delaisi, 1933; Robbins, 1934).

I

Generally, at that time countries used independent strategies to adapt to the crisis. Three blocks were formed: first group countries devaluating their currencies (United Kingdom, the USA, and for example Bulgarian neighbour Greece (1932); second group countries maintaining the gold standard, with France in the lead, and conducting strict deflationary policy to limit wages and prices growth; and, finally, third group countries preserving exchange rate parity and exercising strong exchange control (Germany, Italy, Hungary, Austria). Bulgaria joined the third group, being sceptical of the foreign trade liberalisation measures recommended by the 1927 Geneva Conference. Bulgaria continued to maintain the fixed exchange rate and its convertibility, and after the devaluation of the US dollar in 1933 the lev was fixed to the French franc. After the devaluation of the franc in 1936, the Governing Council of the BNB

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continued to maintain the fixed exchange rate arguing that „we are not directly hurt by these devaluations and at the moment there is no need of certain adjustment measures, and our export will follow its own way (BNB, 2004a, 557-562)."

The devaluation of the main currencies made Bulgarian economists finally begin to treat the crisis as deeply fundamental, and most importantly, as having numerous manifestations. The range of analyses increased. The basic range of issues, apart from the explanations of the currency crisis, were narrowed down to monetary issues, exchange rate and trade control, the condition of the banking system and the need for its regulation; providing stimulus for the national industry through protection for the national economy, and Bulgaria’s external debts servicing.

The above topics were not only the result of the serious problems confronting Bulgaria’s economy, but they were also provoked by the development of western thought and „attacked” with the instruments of modern western theories. These were mostly the new theories of managed or administrated social economy, which placed at the core the role of state and government (incarnation of state power) as a mediator and supreme arbitrator between the antagonistic social classes and groups. Under different variants, this model was popular in Germany and Italy and was concretely examined in a number of economic papers. It was not accidentally that in this period, for the purpose of popularisation and winning recognition, the Bulgarian economists invited renowned scholars, among whom Werner Sombart (1932) and Mihail Manoilescu (1933). During that period a number of Italian scholars visited and had their works translated such as the jurist Giorgio Del Vecchio (visited Sofia in May 1934) and the politicians and jurists Giuseppe Botai and Alfredo Rocco (translation of their book in 1934).

The reasons for the crisis and depression were sought in the deep economic and political disequilibria speeded after WWI and the peace treaties, something which, incidentally, most Bulgarian economists, who were actively involved in the country’s political life, never stopped repeating. One such example was Alexander Tsankov who considered global balances and flows of savings, investments, and gold changed, and industry going through deep technological transformation with machines becoming of mass use (Tsankov, 1929; 1932). To him:

„The crisis started already before the war and it, perhaps, could have grown to the same scale: so deep, horrendous and huge as it now is; the war however speeded up its progress” (Tsankov 1932: 3).

As regards Bulgaria, Tsankov saw the dependency of small and peripheral countries on the centre, and in his recollections, he would say:

„Regrettably, small countries and in particular the countries on the Balkans have always been minor pawns, with which the big countries have balanced their accounts” (Tsankov 1999 [1953]: 283).

Later, in his memoirs written in Argentina, Tsankov would point out the difficulties in the geostrategic choice of the country, the split in Bulgarian identity:

1 See Bobchev (1933), see Babulescu (2003).
„Our tragedy is our divided identity [...]. We, Bulgarians, harboured two souls, so to say, being Russophiles and Russophobes at the same time. [...] In spirit and culture – close relatives, politically and socially – divergent.” (Tsankov 1999 [1953]: 114).

Regarding the outlook for the economy and economic policy, Alexander Tsankov is clear:

„One thing, however, must not be forgotten; namely, that from now on the state as a representative of democracy and economic democracy in particular will tighten more and more its control and its governance in social life as well. This could perhaps be just an earlier phase to yet another reconstruction of the world; however, observing life we can say that state is interfering more and more by way of control and governance in all areas of life, especially in economic and social life (1932, 16); From now on the state will interfere. This is perhaps the new that we see coming (1932, 18).

In the keynote speech of Democratic Alliance (Democraticheski sgovor) movement, held on 12 June 1932, Tsankov demonstrated some of his old principles of the historical school by saying that despite the positive that he found with Italian fascism and Hitlerism, we should look for our own specific Bulgarian model of managed state economy. In his view:

„We will do what we can and will try, in accordance with the soul of the Bulgarian people and its political, economic and international position, to create our own genuine, home-spun Bulgarian movement…” „Capitalism however will prevail. The question is what form, what new forms it will take in order to provide new stimuli for human progress.” „[...] to encourage reconciliation between workers and capitalists through the mediation of the state.” (Tsankov 1932a).

II

Monetary regime became the main topic of analysis and controversy, rekindling to some extent the debates from the period before the stabilisation of the lev about the level of the lev fixing and the level of money supply coverage. There was a wide consensus among our economists about the need to retain the old lev parity despite the devaluation of the main currencies and our neighbours’ currencies. Indeed, with time, pro-devaluation ideas did sneak in, but this happened at a later stage. As an alternative to devaluation and deflation, the Bulgarian economists began to analyse actively the possibilities of exchange control and the future monetary and non-monetary mechanisms within the frame of the German zone.

In analysing the devaluation of the sterling pound and the Deutsche mark, Alexander Tsankov saw them as inevitable consequence of the movement and structure of monetary and capital flows globally, largely attributable to debts and reparations. According to him (Tsankov, 1932, 7), having received its reparations from Germany, France hoarded reserves, which, through England, were once again recycled in Germany
in the form of short-term loans from British banks. Moreover, as these funds were invested in long-term projects in Germany, when confidence declined the British banks could not claim back their receivables from Germany. This undermined the sterling pound. Although gold was a significant factor of economic development, it was still a „fetish”, and its uneven distribution among individual countries was noxious.

The fragile chain of monetary payments between countries due to the crisis, as exposed by Tsankov, was close to the schema proposed at the same period and later by different western authors (as for instance Delaisi, 1933, Baudin, 1937 among many others).

The leading Bulgarian economists concurred on the benefits and advantages of the gold standard internationally and at home, which continued even after the devaluation of the French franc in 1936 (as mentioned above, Bulgaria practically never devaluated\(^2\)). In sync with these positions was the support bestowed by our economists to the French orthodox monetary theories of Charles Rist and Bertrand Nogaro in their debate with the proponents of the „guided currency [{\textit{upravliavanata moneta}}]”, mainly promoted by British economists (including Hawtrey and Keynes) (see Kalinov, 1932, Mollov, 1935). Especially clear on this point was for instance Lyubomir Yankov who was against an eventual devaluation of the franc, and this being already a fact (according to his calculations a devaluation of some 25-35%) – he regarded it as catastrophe. In his view:

„Will a depreciation of the French franc put an end to these concerns? Certainly not. [...] A balanced policy of saving conducted in a peaceful environment is an absolute must for public credit to recover. Any other orientation would only fatally lead to a „guided currency”, much as illusionary the advantages of such a monetary system could be.” (380); „Raymond Poincare’s franc collapsed as a result of disrupted state finances” (494). „National currency devaluation always brings with itself relief to debtors and loss to depositors and creditors.” (Yankov 1936: 505).

A similar conservative attitude to devaluation was held by another economist, Assen Ivanov, BNB Governor, who published two articles placing foremost importance on the key role of savings in exiting a crisis (Ivanov, 1933, 1936). To him:

„Devaluation may only be likened to an injection made to an ill person to alleviate the pain for a few hours, to soothe him for a while”; „Whoever is pleading today in favour of cheap money as a means of boosting up the economic life in our country, is wrong. Cheap money and devaluation cut both ways, and if they are not properly manipulated, there is the danger of ending in losses rather than achieving good results” (Ivanov 1936: 582-583).

\(^2\) Germany and Hungary also never devaluated officially. Although Romania also kept the exchange rate parity, in 1936 it devaluated de facto when revaluating its gold reserves, adding the 38% premium (Blejan and al., 2009). The questions whether or when the country gave up some of the characteristics of the gold standard are methodologically very difficult to answer. Some authors suggest this occurred when the exchange rate control was introduced, usually in 1931/32; the gold exchange standard was de facto abandoned, because the free movement of gold was limited (Wandschneider, 2006).
Assen Ivanov not only described the technical problems of the losses resulting from devaluation (including the role, which in modern terms would be „the theorem of critical elasticities” of foreign trade), but he was also definitely in favour of encouraging savings rather than demand. As we already know, this was the watershed of the disputes held at that time. The same conservative view was held by Assen Chakalov, who however saw the salvation for Bulgaria lying in foreign exchange restrictions and protectionism:

„Although the devaluation of the French franc, the Italian lireta and other currencies do create certain difficulties for debtor countries in relation to their trade development, and especially for their exports, they are nevertheless in a position to keep their system by means of protection premia on exports and boost the development of their economy”; „Fluctuations in the value of the national currency are always dangerous and create obstacles to the normal functioning of the economy” (Chakalov 1936: 600-603).

At the same time, there were some shy attempts to look positively on a devaluation, as well as attempts to study and spread the idea of the „guided currency [upravliavana moneta]”. In this respect, worthy of mention are young Assen Hristophorov’s allusions in one of his first articles where, after his stay in London, he described the consequences of the devaluation of the sterling pound and the dollar, saying:

„Because all things considered, it is not the vastness of the gold reserve stock at the central bank, but the internal and external economic equilibrium, which guarantee the stability of the national currency unit. [...] In an eventual devaluation, the fear of a fast, strong and speculative pick up in wholesale prices and a rise in the cost of living in general is ungrounded. [...] a possible devaluation of the coins of the gold bloc would have a faster and more efficient impact on domestic prices than in the case of the English devaluation” (Hristophorov 1935: 261).

The subtitle of the article („Deflation or Devaluation”) indicates that it was directly influenced by the numerous publications on this subject, including by Keynes. It might be interesting to note that two years later, after the devaluation of the franc, in one of his articles Hristophorov (1937, 234) clearly mentioned the pick up in prices in France (22%, which was higher than in other countries) with devaluation already a fact. There again, and in one next article about the state of global conjuncture, Hristophorov explicitly underlined the fast development of virtually all countries after devaluations, by implicitly stating his view that gold is „chains” to economic development (similar to Keynes’s and Eichengreen’s interpretations).

Zhelyo Burilkov, a BNB deputy governor, made an exhaustive and particularly extensive analysis of the new theories and techniques of the Central Bank, where though implicitly, the discretionary monetary policy was given a support (Burilkov, 1934). It is interesting that Burilkov sided with the economists who believed that monetary policy is a science and theory, and not only art, practice and experience.

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3 For more information, see Rist (1933), Baudin (1937).
(The analysis presents the ideas of Hawtrey, Keynes, Wicksell, Cassel and Fischer. Keynes is not clearly distinguished from the rest, and the LLR function is not explicitly mentioned (the article speaks about the „bank of banks”) although some of Bagehot’s views are introduced.)

III

If we should summarise the arguments, which Bulgarian scholars upheld against devaluation and deflation, and in support of exchange control, these could be narrowed down to the following:

First, as already mentioned, Bulgaria was a debtor country that considered debt service a key priority. In fact, Bulgaria was an extremely diligent payer who pursued to preserve its reputation through debt service. Due to its political isolation after WWI, however, its endeavours as a good payer were not recognised and it had to shoulder its liabilities with almost no relief (Ivanov, 2001, 2004). In his speech marking the BNB’s 50th anniversary, then-prime minister Andrey Lyapchev said, „one would be hard put to find quite such a young nation in quite such exacerbated circumstances as ours these past fifty years, yet one which can boast that it has ever occupied the position of an exemplary payer to its foreign creditors” (BNB, 2001,135). With respect to structure, Bulgaria’s debt was denominated in gold backed leva and was mostly owed to non-devaluing countries. According to The Royal Institute of International Affairs, „in Bulgaria it is almost certain that the transfer question has predominated” (1936, 98) and the purpose of maintaining the currency on a gold basis „has presumably been to avoid an increase in the costs of the foreign debt service” (1936, 129). Even before reparation payments began in October 1923, foreign debt service reached the amount of 112 million gold francs in 1918 to 1922: 16.3 per cent of budget expenditure. This represented a quarter of the national wealth. Sterling devaluation offered some relief to Bulgaria since its debt was predominantly in pounds. Debt service now accounted for 11 per cent of budget expenditure; there was no great BNB asset loss since a comparably small amount of assets was denominated in sterling. Summarising the opinions of many economists at that time, a hypothetical devaluation would certainly increase national debt burden, while any possible advantages would be marginal (Saraïliev, 1937, 27).

Second, the balance of payments constraints were particularly tight, and not only with regard to foreign debt service. The prices of agricultural products, which accounted for the major part of Bulgarian exports, fell sharply on international markets and aggravated the terms of trade. The September 1932 Stresa Conference that focused on possible assistance to Southern European countries (a major part of the so-called „agrarian bloc”) noted that the price drop reached 70 per cent (Bonnet, 1933, 21). A fund concentrating revenue from the sale of agricultural products to developed countries was proposed to be used as partial debt service (the United Kingdom vetoed it).

Third, systematic exchange control could be interpreted as a defence against restrictions introduced by Bulgaria’s trading partners and their abandonment of the
gold parity. The farming price drop was combined with a number of restrictions on the import of agrarian products to Germany and France with a view to protecting indigenous farmers through economic and political means (Raupach, 1969). Turkey, an important Bulgarian trading neighbour, also introduced some restrictions on Bulgarian imports. In April 1932, the drachma joined the devaluers’ club and Bulgaria lost its competitive and long-standing positions on the Greek market.

The fourth and direct cause of exchange control was the intensification of capital outflow from Bulgaria at the end of 1931. In addition to this global imbalance, Bulgarian economists provided a list of long-term domestic factors like the purge and confiscation of capital claimed to be illegally accumulated during the Wars, and political instability, which certainly contributed to decreasing Bulgaria’s capital accumulation and foreign reserves.

Also of interest in this period were the discussions of the banking dimension of the crisis. A known fact is that over the period 1931 - 1935 the number of banks declined from 131 to 98 due to failures and consolidation (Kemilev, 1936). According to Kiril Kossev’s recent study (2008), the banking crisis in Bulgaria was one of the severest: only in the period 1929 - 1932 bank deposits decreased by 50%. Laying the foundations of banking supervision with the establishment of the Bankers Board (Bankerski savet) and the introduction of a range of accounting rules were a manifestation of recognising the need for a regulated financial system and the weaknesses of the free market. All these measures could be interpreted as manifestations of a general trend toward greater state interference in the economy and more active monetary policy.

As was already indicated, the last phase of the Great Depression was the disintegration of the world economy into several blocs with Bulgaria making its choice in favour of the Germany administrated area of influence. The exchange control, and later on the clearing treaties became a key monetary instrument in fighting deflation and crisis. A detailed account of the exchange control and clearings in historical perspective is given in Nenovski and Dimitrova (2007). One of the most active group of Bulgarian economists among the five mentioned, the Marxists’ group, was extremely active in this period, shaping one of the main traits of Bulgarian theoretical interpretations of the Great Depression. This group displays some worthy of note and curious features, which account for much of the specifics of the Bulgarian interpretation of depression from that period.

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