Small State Autonomy in Hierarchical Regimes.

The Case of Bulgaria in the German and Soviet Spheres of Influence 1933 – 1956

By

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Statement

I hereby state that the thesis contains no materials accepted for any other degrees in any other institutions. The thesis contains no materials previously written and/or published by another person, except where appropriate acknowledgement is made in the form of bibliographical reference.

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Abstract

This thesis studies international cooperation between a small and a big state in the framework of administered international trade regimes. It discusses the short-term economic goals and long-term institutional effects of international rules on domestic politics of small states. A central concept is the concept of authority in hierarchical relations as defined by Lake, 2009. Authority is granted by the small state in the course of interaction with the hegemonic state, but authority is also utilized by the latter in order to attract small partners and to create positive expectations from cooperation.

The main research question is *how do small states trade their own authority for economic gains in relations with foreign governments and with local actors*. This question is about the relationship between international and domestic hierarchies and the structural continuities that result from international cooperation.

The contested relationship between foreign authority and domestic institutions is examined through the experience of Bulgaria under two different international trade regimes – the German economic sphere in the 1930's and the Council for Mutual Economic Assistance (CMEA) in the early 1950's. These are two very restrictive regimes of administered economies and bilateral clearing trade. Both core countries of these regimes extend economic benefits to the small states in order to legitimize their rule and build international authority. The Nazi and the Soviet regimes relied on authority to a different extent and used it at different points in time to legitimize their power. Nazi Germany used soft power in the early 1930's to attract economic cooperation, which evolved to hard power and economic exploitation during WWII. Soviet power at the end of WWII was in the form of military occupation and economic exploitation and gradually took a softer form including economic concessions to its sphere of influence.

In both cases the small state had a certain degree of authority and was able to extract short term economic benefits from cooperation with the hegemon. I argue that the small state has more agency than it is usually assumed in the literature.

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Table of Contents

Introduction **1**

Chapter 1: The International Trade Regimes of Germany 1932-1939 and the Soviet Union 1949-1956 .... **13**
- **1.1. Defining Bilateral Clearing** **15**
- **1.2. Different Political Ends** **23**
  - 1.2.1. International division of labor 24
  - 1.2.2. Raw materials and autarky 26
  - 1.2.3. Ideology and institutions 28
  - 1.2.4. Security 32
- **1.3. Different Global Conditions** **33**
- **1.4. Similar Economic Means** **37**
- **1.5. Puzzle and Research Question** **40**
- **1.5. A Case of International Trade Regime Continuity** **45**
- **Conclusion** **48**

Chapter 2: Literature Review, Theoretical Framework and Case Selection **50**
- **2.1. Definition of Small States in Hierarchical Relations** **51**
- **2.2. The German Offer for Eastern Europe in the 1930's – Economic Exploitation or Economics in Hard Times?** **53**
- **2.3. The Small East European States** **61**
  - 2.3.1. Yugoslavia in the German economic sphere 66
  - 2.3.2. Romania in the German economic sphere 68
  - 2.3.3. Bulgaria in the German economic sphere 73
- **2.4. Theoretical Framework** **78**
- **Conclusion** **89**

Chapter 3: Bulgarian-German Relations – Foreign Sources of Domestic Institutions **90**
- **3.1. The Great Depression in Bulgaria and Germany** **91**
- **3.2. Establishing Bilateral Trade Relations Bulgaria - Germany 1931-1932** **95**
- **3.3. Growing German Influence** **98**
- **3.4. Financing of Exporters and Inflationary Effects** **106**
- **3.5. Wartime Economic Relations** **112**
- **Conclusion** **115**

Chapter 4: Effects of the Clearing Regime on Domestic Structures: State Corporatism in Bulgaria **116**
- **4.1. Bulgaria and Germany in Hierarchical Relations** **117**
- **4.2. State Corporatism in Bulgaria 1932-1939** **126**
  - 4.2.1. The organization of foreign trade in Bulgaria 127
  - 4.2.2. The interests of exporters 135
- **Conclusion** **140**

Chapter 5: The Transition from German to Soviet Hierarchy 1944-1956 .... **142**
- **5.1. Transfer of the German Assets to Soviet Possession** **144**
- **5.2. From Foreign Trade Isolation to Foreign Trade Reorientation** **151**
  - 5.2.1. The change of personnel 157
  - 5.2.2. The changes of trade structure 163
- **5.3. The Origins of the Council for Mutual Economic Assistance** **166**

5.4. Institutional Framework of the CMEA ... 171
Conclusion ... 177

Conclusion ... 179

References: ... 185

List of Tables and Figures

Table 1. Terms of Trade..58
Table 2. Germany's Trade with Southeastern Europe, 1929 - 1938..........................62
Table 3. Germany's clearing debt with Yugoslavia, 1934 - 1938 (in million dinars)...66
Table 4. Money in Circulation in Bulgaria during the Great Depression.....................76
Table 5. Shares of CMEA trade and USSR trade in total trade of socialist countries 88
Table 6. Foreign Reserves of Bulgaria, 10.1929 - 02.1930.......................................92
Table 7. Foreign reserves, gold coverage ratio and trade balance, 1927 - 1939.......93
Table 8. Foreign Exchange Flows 1932 - 1934..99
Table 9. Foreign exchange balance of BNB in million levs..................................... 101
Table 10. The Free account 1936 - 1938..103
Table 11. The share of German imports and exports in total trade and in total clearing trade...104
Table 12. Indices of wholesale prices and cost of living (the year 1929 = 100).......110
Table 13. Money in circulation and the increase of blocked reichsmarks in the clearing account, 1940 – 09/30/1944...113
Table 14. Trade Patterns of Five East Central European Countries, 1937 - 1952...156

Figure 1. Exports to Germany as percentages of total exports. 63
Figure 2. Imports from Germany as percentages of total imports. 64
Figure 3. Germany's share in the foreign trade of Southeastern Europe as percentages of total trade in 1938. 64
Figure 4. Germany's clearing debt to Yugoslavia, 1934 - 1938. 67
Figure 5. Money in circulation in Bulgaria in million levs. 110
Figure 6. Indices of wholesale prices and cost of living. 111
Figure 7. Asymmetric trade dependence, Bulgarian exports to Germany in 1938 .. 122
Figure 8. The clearing and the free account of the BNB in million levs. 123

List of Abbreviations

BGN – Bulgarian national currency, lev
BCR – Bilateral clearing regime
BNB – Bulgarian National Bank
CPE – centrally planned economy
CPRO – Central Public Records Office, the state archive in Bulgaria
CMEA – Council for Mutual Economic Assistance
Comecon – Council for Mutual Economic Assistance
DB – Deutschebank
EE – Eastern Europe
EC – exchange control
EI – Export institute
Gosbank – the central bank of the Soviet Union
RM – reichsmark
RB – Reichsbank – the central bank of Germany during the Third Reich
SEE – Southeastern Europe
USSR – The Soviet Union

Introduction

Monetary and trade regimes are not politically neutral. By facilitating international economic cooperation they produce interdependent relationships among states. They also alter the incentive structures within states, which affect domestic politics. Regimes are neither all-inclusive nor truly global rather concurrent regimes function across and between regions and sectors. There are two basic regime types - *liberal* and *administered* regime types. The first allow for the free flow of capital and goods across borders in a multilateral payments system. The dominant regime of multilateral trade in convertible currencies and the classical Gold Standard are examples of liberal regimes. The second type of regimes operates on bilateral clearing basis where payments are in kind or in non-convertible currency. Germany in the 1930's, the socialist market led by the Soviet Union 1949-1991 and present day China's regional trade with East Asia and Africa are some examples of administered regimes. There is abundant scholarship in the international political economy field studying the positions of dominant states, their motivations for introducing international regimes, interests pursued and costs incurred. Major works on the position of small states focus on advanced industrial states and how they adjust to global markets but relatively little research is devoted to the economic policies of small states in non-liberal regimes.

This thesis looks at the bilateral clearing regimes advanced by Germany in the 1930's and the Soviet Union in the early 1950's. It asks the question how was regime continuity sustained across drastic change of regional hegemonic power. It hypothesizes that small states' cooperation is vital for the continuity and durability of international regimes. Additionally small states' loyalty legitimizes the regime as a whole and the dominant state's position as global or regional leader in particular. In an international system of legal equality among states, small economies are attractive to powerful states because they are easier to absorb as economic partners at the same time their political friendship counts as influence over an entire foreign polity. In order to secure this positive authority, the core countries are ready to forgo a marginal opportunity for economic exploitation and to restrain their own power (Ikenberry, 2001).

Small states on the other hand depend on external markets and their domestic politics often reference an external authority. They are ready to give up some authority over economic policy in exchange for resources or access to markets. Yet, they retain a sufficient degree of authority over their domestic economies. Motivated by these observations, the project makes a contribution to understanding the small state policy dilemmas in the framework of international and domestic hierarchies.[1]

This project differs from Dependency theories in that it goes beyond the assumption that small states are invariably subordinated by demonstrating that the limitation on their choice is not so much imposed by a foreign polity but by domestic economic structure. In order to bring forward the characteristics of the regime itself and not those of the core country, which promotes it, I take the bilateral clearing regimes promoted by two different regional leaders and used in two very different ways - the regimes of Nazi Germany and the Soviet Union. From the point of view of their East European trading partners the rules of international exchange were similar enough to be seen as one continuous regime of international trade. The reasons for its continuity after the change of the regional hegemonic power should be sought not

[1] The framework of hierachy in international relations and definitions of sphere of influence that I follow is based on Lake (2009), Cooley and Spryut (2009) and Clark (1989).

simply in the trade relations between a dyad of countries but in a clearing mechanism itself, which operates across ideological differences.

The analysis unfolds in two levels using an adapted principal – agent approach. The first level is the hierarchical relationship between the small state (agent) and the dominant state (principal). First I analyze the bilateral clearing regimes where Germany and the Soviet Union hold constant positions of principals throughout the studied period. What varies is the relative bargaining power of the small state, measured by its ability to extract economic gains or upload its preferences in the form of rules to the international level. The bilateral clearing regime is seen as an institution of self-restraining hegemonic power within which the dominant state is able to extend economic benefits to the small states in exchange for acquiring international authority.

The second level of the study looks at authority as negotiated between the small state and the domestic actors within it. For the small countries the political choices are rarely between alternative ideologies or systems but between economic threats and opportunities in the context of domestic political struggles. They are studied along the three dimensions of Katzenstein's model of "small states in world markets": *state centralization*, *societal centralization* and *policy networks*. Although these dimensions were developed in the context of advanced industrialized democracies, their central meaning is applicable to small states in general including less industrialized and less democratic states. The analysis is relevant for present day small states under this definition and for other international trade regimes, which exist as an alternative to the global market.

In the period of Germany-dominated foreign trade the state increased its grip on the economy, control over economic operations became more centralized but at the same time the state acted as an agent of domestic interest groups and advanced some of their demands at international negotiations. These interest groups are seen as the principal. The domestic political economy looks like a mix of strong state centralization and societal decentralization within a corporatist policy network.

In the second period (1944-1956) the state itself was the principal and domestic actors served as agents who executed the political goals defined by the state. In relation to the previous period we observe higher state centralization, societal centralization and a hierarchical command-based policy network. This part of the analysis concludes that the adoption of foreign models is not a mechanistic process of foreign imposition of domestic institutions or an emulation of the domestic political economy of the big by the small state. It was rather a process dependent on the mode of cooperation between the two.

Bulgaria is chosen as a case of a small state in hierarchical relations. It is geographically small, economically under-developed and lacking resources for its industry, hardly hit by the Great Depression, with chronic balance of payments problems and heavily indebted it was in a weak bargaining position *vis-à-vis* both core states and most likely to accept choices which did not advance its interests.

In addition both Germany and Russia enjoy traditionally high reputation in Bulgaria. During the Interwar period Germany is the epitome of higher culture, technological superiority and not least as the motherland of the Bulgarian king Ferdinand. Russia is the long-awaited liberator of the Bulgarian people from the Ottoman Empire and the closeness of its Slavic culture and Orthodox religion tie into a deep-seated brotherly sentiment. Against the odds of economic weakness and strong foreign political authority, the case of Bulgaria is nevertheless a case of choice, which a small state makes for itself in times of crisis. These choices are limited to its domestic sphere and related to the institutional organization of the foreign trade sector in response to external economic cooperation but they are choices worth studying. The thesis demonstrates that even in the case of small countries with limited economic resources and no political influence outside their own borders (and often over their own borders) cooperation in international regimes depends on choices made within the small state. It is ultimately a thesis making the argument for agency on the part of the small state.

The project addresses the International Political Economy scholarship by speaking to a familiar puzzle – the continuity of a regime after decline of power. It is also relevant to historical studies of the region of South Eastern Europe and combines economic history with political economy at both the domestic and the international level. It has a two-step structure – economic history narrative and theory testing. It focuses on sequential processes with a single historical case and uses the methodology of causal process observation. It sets off by defining the bilateral clearing regime against alternative trade arrangements. Unlike free trade and the multilateral payments system, where exporters receive payments in convertible currency and as a rule are free to spend it in different countries, bilateral clearing trade is facilitated in the absence of international money - imports and exports between pairs of countries are to balance out. Exporters can spend their revenues only in the same country where they sell their goods. In order to facilitate this kind of trade the central bank has to control not only the inflow and outflow of national and foreign currency but also in effect controls imports and exports in terms of their importance for the national economy. What became the norm under a Communist foreign trade regime was in fact established ten years prior to it.

The project further follows the development of the regime emerged during the Great Depression when regional trade and payments arrangements replaced the global open economy. The immediate measure against capital flight and devaluation in most European countries was the introduction of exchange controls, which limited the use of foreign currency in international trade and the convertibility of domestic currency into foreign exchange. Under these conditions international trade could only continue in the form of barter, immediate compensations between importers and exporters, or bilateral agreements cleared in the domestic currencies of the two countries. Other European powers remained on the Gold Standard (France) or organized bilateral trade based on tariff preferences (Great Britain) and international trade proceeded within a number of regional blocs, advanced by a leading country under different monetary rules.

Between 1932 and 1935 Germany initiated a number of bilateral clearing agreements with the countries in Southeastern Europe, which had imposed exchange controls. Bulgaria was the earliest and most dependent on Germany trading partner. It supplied agricultural goods wheat, tobacco and later fruit and vegetables at higher than world prices and imported in exchange machines, military equipment and industrial raw materials. The trade, however, was not balanced and despite the written agreement Bulgaria often exported in advance of payments and credited German consumption. Bulgarian Central Bank and the Ministry of Trade had the choice between waiting for counter-imports from Germany to supply the needed cash for paying the exporters or to finance them through self-generated means. It opted for the latter.

Accepting German authority and bilateral clearing relations resulted in the emergence of a state corporatist model in Bulgaria, which is not seen as an imitation of the Nazi economy, rather a reaction to it and a consequence of domestic input as well as external demand. Compared to the German “model”, the domestic regime in Bulgaria evolved to a higher centralization of the state but not to as high a centralization of society.

One of the research findings is that societal groups in Bulgaria had a higher degree of freedom then their German counterparts. They expressed disagreement with the state and demanded that it served their interests; the demands and criticisms were exercised openly and in a formal way within a state corporatist policy network and often received the desired outcome. This means that the state corporatist model in Bulgaria resulted not from imitation of the Nazi totalitarian state but as an imitation of the fascist economic model and in close cooperation with it.

The contested relationship to German authority is evident from the attempts of Bulgaria to diversify its international trade partners. Already in 1940 Bulgaria signed bilateral clearing agreements with the Soviet Union in order to secure the raw materials – mainly coal and gasoline that Germany failed to deliver. It also pursued partial multilateralizing of trade with neighboring Southeastern countries with no success.

Following the end of WWII Bulgaria reoriented its trade towards the Soviet Union on the basis of the 1940 bilateral clearing agreement. The same trade regime continued to operate uninterrupted as the organizing principle of the Council for Mutual Economic Assistance and remained so until the end of the socialist period. From the point of view of Bulgaria the mode of cooperation with their dominant trading partner did not change significantly from the pre-Communist to the Communist period. The domestic regimes differed in the level of state and societal centralization. Under the Communist regime the centralization of the state was even greater than before the War but in addition centralization of society also increased. But while these visible changes of domestic structure were taking shape on the surface, the underlying logic of international trade remained unaltered for decades. The incentive structure for exporters was to direct the low quality goods to the "friendly" countries and exchange them under clearing for similarly selected items and aiming to sell the few competitive goods on the free market for convertible currency. This resulted in a rigid economic structure and a lasting "mindset" of evading competition and quality upgrading.

In his "Small States in World Markets" Katzenstein describes how political stability and economic flexibility produce a competitive domestic structure in advanced industrialized states. The conclusion of the thesis is that in the case of less advanced, under-industrialized and non-democratic states political instability and economic rigidity locks in a structure of perpetual transfer of authority abroad and arbitrary allocation of domestic resources. Both shifting authority abroad and domestic allocation are seen as evidence of agency in line with a realist assumption that interdependence is the result of state policies not the other way around Gilpin (1975), "it exists because they (states) allow it to exist" (Gourevitch, 1978). This agency is the key to explaining regime continuity.

The comparison of the bilateral clearing regimes in the two periods suggested here is a comparison of the small state position in two very different spheres of influence operating on different economic logics and within different ideological frameworks. It sheds light on processes of continuity and change typical for non-democratic under-industrialized small states in relation to a bigger trade partner.

Besides explaining regime continuity across power shifts, this analysis of the bilateral clearing *per se* is relevant to present day China's trade relations with resource-rich countries in Africa. Some of these states can be seen as transitioning from the sphere of influence of the USSR and the socialist democracies to the sphere of influence of China, a structural change that is underwritten by the continuity of a regime of non-competitive and non-market-based trade. This kind of bilateral countertrade is practiced also by China and its East Asian neighbors; Turkey and Iran; India and Iran and is an important mechanism of skirting the multilateral trading system.

Taking the analysis back to the macro level of the international system, the project offers a conceptualization of a “shadow regime” which starts to operate where the dominant regime of multilateral trade in convertible currency ends. It also points to the opportunities and limitations small states face in relation to external authority.

Chapter one provides a comparison of the clearing regimes of Nazi Germany and the Soviet Union demonstrating that despite many differences the two regional hegemons used the same international trade regime with Southeastern Europe. The comparison concludes that the regimes were similar in their institutional form while different in substance. The question why did they use the same regime is first approached from the point of view of the theory of totalitarianism. The explanation that totalitarian control spread from the domestic to the international sphere is found to be insufficient in view of historical evidence and an alternative approach is suggested. The hypothesis is that the regime spread not from the domestic to the international sphere but from a previous international regime to the next with the active cooperation of the small partner states in Southeastern Europe.

Chapter two looks into the theoretical discussion of bilateral clearing and its historical occurrences and argues that unlike other practices, such as the clearing with the Sterling Area, the practice advanced by Germany in the 1930 and by the

CMEA is not a currency bloc but constitutes a specific trade regime. The chapter also defines the theoretical framework of the rest of the dissertation. Hierarchical relations in this case are not simply relations between a big and a small state with uneven distribution of material capabilities, but a relationship where the small state “gives up certain economic or security autonomy in recognition of a legitimate influence or rule”.

Chapters three and four demonstrate the relations between Bulgaria and Germany in the period 1932-1939, first focusing on the question of external authority, the debates over the strong economic position of Germany and its potential ability to exploit small partners and then discussing the domestic institutional changes in Bulgaria, the emerging state corporatism and state monopoly over foreign trade and payments. The chapter demonstrates that “the state” in this context understood as the policies and institutions still acted as an agent of domestic economic interests and its role in trade organization was largely perceived as enabling and positive by the professional circles. In the discursive framework of economic nationalism dependence on Germany was justified and state control over foreign trade was legitimized with economic argumentation. State corporatism of the 1930’s was qualitatively different from state monopoly in the socialist period.

Chapter five looks at what happens to the subordinate states when authority shifts from one center of power to another. It traces the transition from German to Soviet power in a new hierarchical relationship after 1944. Foreign authority continued to play a decisive role in domestic politics but in this case the Bulgarian state and its national interests were defined by the communist bureaucracy and legitimized through communist rhetoric of eternal friendship with the Soviet Union and socialist economic assistance. During the founding session of the Council for

Mutual Economic Assistance when its institutional arrangements were established formally, Bulgaria argued for the same mechanisms that were in operation during the 1930’s: artificially high prices for its exports, guaranteed markets and deliveries of raw materials, a trade bloc closed for external competition where lower quality goods could easily be placed. The political and economic elite of the 1930’s was replaced with new cadres, loyal to the Communist party. However those were not experienced foreign trade professionals and were not able to organize the foreign trade sector as efficiently as in the 1930’s. The chapter demonstrates this lack of bureaucratic capacity and interprets it as a major factor for the adoption of the bilateral clearing regime. One of the mechanisms of policy transfer works through the bureaucracy – while the Soviet Union had very low bureaucratic expertise in foreign trade organization, the bureaucracies of the Southeast European countries had an already developed and working model to offer.

Additional explanation for continuity is the preferences and interests of the small states. The least competitive economies had the most to gain from a system of administratively managed foreign trade prices and exchange rates. Similarly to the Nazi economic plan for post-war Europe, the Soviet Union at least in the beginning of the Council for Mutual Economic Assistance (CMEA) was willing to buy at higher than world prices from the socialist bloc. However, the small states were not passive recipients of this policy but actively demanded this arrangement at the founding meetings of the socialist trade bloc – the CMEA. The thesis concludes that in the context of peaceful cooperation small states have more autonomy over economic policy than it is usually assumed when discussing the Nazi and Soviet spheres of influence.

Throughout the thesis I treat trade is an act of willing cooperation and exchange, which is distinct from the instances of extraction during the time of war occupation. War was important in the transfer of resources from Bulgaria to the Reich in the 1930's and from the Reich's accounts in Bulgaria to the Soviet government. However, I demonstrate that the extent to which a country participated in the bilateral clearing market was limited by a combination of its own economic structures and institutions. After the end of the Second World War they could not chose the political bloc and the security alliance they became a part of, but they could chose their trading partners as long as they could reach bilateral agreement.

The methodology I use is a causal process observation within a particular historical case. Although there are elements of comparison of two historical cases, which can be viewed as two different hegemonic regimes, the thesis interprets at the outset similarities between the two to constitute a single trade regime and studies it as a case of continuity. The historical narrative relies heavily on contributions from economic history and original archival research while the analysis contributes to the development of theory of small states in hierarchical markets as part of the international political economy literature.

Chapter 1: The International Trade Regimes of Germany 1932-1939 and the Soviet Union 1949-1956

The political regimes of Nazi Germany and the Soviet Union have been contrasted and compared many times. From the point of view of the theory of totalitarianism these regimes have been extensively conceptualized (Ahrendt, 1979; Friedrich, 1964; Friedrich and Brzezinski, 1956; Adorno, 1993, Popper, 1950). Recently the concept of totalitarianism has undergone a critical revision (Geyer and Fitzpatrick, 2009). The war mobilization efforts of the two WWII antagonists have also been compared (Milward, 1977; Tooze, 2008). The comparative economic systems literature investigates the different organization of the domestic economy in the Soviet (Bornstein, 1965; Holzman, 1974) and the Nazi (Eucken and Hutchison. 1948, 1948a); (Eichengreen, 1995) cases. Economic planning in the 1930s has also been studied comparatively (Temin, 1991). Much research is dedicated to the question of economic exploitation during the War. However, comparative studies of the international economic relations of these two hegemonic powers with countries of Eastern Europe are very limited. The question how they organized peacetime economic cooperation in their spheres of influence is rarely asked in a comparative context.

Peaceful cooperation here is studied for the purpose of developing existing theories of order in international politics, especially understanding the policy choices of small states in hierarchical relations. The thesis studies bilateral clearing trade as a case of hierarchical international regime. It explains the reasons for the emergence of the trade regime, its development and continuity after the collapse of the political regime that promoted it – the Third Reich.

A bilateral clearing regime is qualitatively different from other arrangements for international trade and payments such as the classical gold standard, operating approximately from the 1820's until 1914, and the multilateral payments system, established in the post-war period. It was in operation for the majority of international trade transactions in Europe after the Great Depression and before the Breton Woods agreement replaced it with the multilateral payments system based on the US dollar. It was also the dominant method of payment within the socialist bloc, allocating resources and finished products within a considerable part of the world between 1948 and 1991.

Bilateral clearing is currently used by China in trade with African countries especially in the import of African oil; it is also used in China's trade with its East Asian neighbors; between Iran and Turkey; India and Iran and is the main alternative to the multilateral trading system in convertible currencies. Although covering a small share of world trade today, bilateral clearing has important political effects. The present thesis offers an interpretation of historical cases, which can contribute to future research in the field.

The current chapter defines the regime and establishes the historical evidence of its continuity. It demonstrates that despite the many differences in ideology, domestic structure and political aims *vis-à-vis* their satellites, Nazi Germany and the Soviet Union created a similar monetary and trade regime with their trading partners in Eastern Europe.

The chapter is structured in four parts. Part one defines the bilateral clearing regime; part two describes the different political ends pursued by the two hegemons in view of which the use of the same trade regime appears puzzling. Part three demonstrates that these regimes emerged out of different global economic conditions in 1933 and 1949 respectively and describes their similarities. The question why these two hegemonic powers with very different economic needs and under different economic conditions adopt similar trade regimes is asked in part four. It also reviews the available explanations provided by theories of totalitarianism and the comparative economic systems literature based on domestic economic management of the hegemonic state. Part five offers an alternative explanation based on the willing cooperation of small states. It presents the hypothesis that the regime was carried on not so much from the domestic to the international level as much as from a previous international regime, to the next.

1.1. Defining Bilateral Clearing

Bilateral clearing trade is not a common topic in mainstream economic theory. There is no definition of bilateral clearing in the Palgrave Dictionary of Finance (Newman, Milgate and Eatwell, 1994) and studying its mechanism is not a part of any textbook of international economics or international political economy (see Krugman and Obstfeld, 2003 or Balaam and Veseth, 2005). One reason for this omission is that standard analysis does not apply to this practice - the price mechanism is replaced with administrative allocation of goods and assets, export and import quotas, artificial exchange rates and price manipulations are in place to the detriment of forces of supply and demand and ultimately to market equilibrium.

Another reason is the highly political nature of this regime. Its goals are different from the goals of a market exchange system - it prioritizes security and strategic considerations over economic efficiency. As a result of these differences it is difficult to study them through the lens of a general theory, applicable to all clearing agreements.

Instead we approach them inductively by looking at various historical and contemporary cases from the point of view of a single state, its concrete motivations and interests in a clearing agreement and the effects the pursuit of these interests has on its domestic economy and institutions. Like other studies of bilateral clearing, this research does not apply formal models to large data sets, but approaches two concrete historical cases and analyzes the development, causes and effects of bilateral clearing within them.

Neither the Nazi Germany nor the Soviet Union invented bilateral clearing, however they used it to the greatest extent for the longest time. As a reaction to the Great Depression many European countries left the gold standard and adopted exchange controls as temporary measures against currency devaluation and capital flight. This severely restricted the free flow of currency across national borders and the free trade regime altogether, making bilateral clearing a common method of enforcing international payments in Europe and beyond. Provoked by its wide spread, in 1934 the League of Nations commissioned a survey to its Economic and Finance organization, following a request by the French delegation. The results of the survey were published in "The League of Nations Enquiry into Clearing Agreements", (Geneva: League of Nations, 1935)[2]. According to the study "[t]he establishment of clearing agreements arose out of conditions created by the institution of exchange control – that is to say state restrictions on the purchase of foreign exchange in the open market" (League of Nations, 1935, II.B. 6:10). The mechanism of bilateral clearing is defined as follows:

> In each of the contracting countries importers of goods from the other country instead of paying their suppliers direct, remit the value of the imported goods in

[2] The League's report was based on the questionnaire replies of the twenty-five countries using clearing agreements: Argentina, Austria, Belgium, Bulgaria, Brazil, United Kingdom, Chile, Czechoslovakia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Latvia, the Netherlands, Norway, Poland, Romania, Sweden, Switzerland, Turkey and Yugoslavia.

> national currency to a special office… From the amounts thus received, the clearing office takes the sums necessary to pay the national exporters for goods sent by them to the other contracting country. Exporters therefore are paid for their goods by the clearing office and not by the foreign customer who bought them...thus linking the same country' s imports and exports closely together (League of Nations, 1935: 65-66).

Unlike normal banking clearing, which is an automatic and spontaneous offset of debts and credits in convertible currencies across borders, bilateral clearing took place within one country in its domestic currency. Unlike barter, which can be conducted between individuals and firms in the same country or in different countries, bilateral clearing organizes trade between *states* where payments are cleared through state-controlled institutions and aggregated national accounts. The report also notes that "[c]learing agreements, although apparently merely a mechanism for effecting payments, have frequently been used as a means of influencing the direction of trade" (Ibid.) Perhaps in an attempt to deny manipulation of trade the governments of Argentina, Brazil, Germany and Turkey did not reply to the League's enquiry and the "United Kingdom government stated that it had not concluded any clearing agreements" (League of Nations, 1935:9). France defined bilateral clearing agreements "as the lesser of two evils" (Ibid., 69); and according to Bulgaria they "have achieved their purpose of averting a still greater evil"; Finland and Chile saw them as having purely negative effects on trade. The Finish response to the question if the extension of the clearing system to the sphere of multilateral agreements is seen as possible and desirable reads:

> …Clearing agreements should therefore be regarded as an evil, which can only be defended when circumstances render it unavoidable. It would therefore be inappropriate to adopt international measures… to secure their general application. (League of Nations, 1935:79)

Denmark reported that the clearing with Germany had served a good purpose and Austria also relayed had positive experience with clearing. Against the benchmark of free trade, the League of Nation's report concludes that these agreements are a deviation from the normal practice of international trade and "expresses the hope that bilateral clearing agreements might be abolished" (League of Nations, 1935, 85). This recommendation against extending bilateral clearing or adopting it as a general practice had however no compulsory character.

Since their emergence in 1932, bilateral clearing agreements were used in the majority of European trade transactions until the creation of the European Payments Union in 1950, which reestablished multilateral trade based on the US dollar[3] and in the Socialist bloc until 1991. Two distinct practices can be outlined: (1) applying bilateral clearing as an emergency mechanism for effecting payments and (2) utilizing them as a general monetary and trade regime covering all payments of commercial, financial and other character and actively directing trade flows and prices. The interwar period agreements concluded by Switzerland, France and Italy with Eastern and Northern Europe and also the Anglo-German clearing agreement of 1934 were an example of emergency measures; the German trade drive to Southeastern Europe is an example of general application. In the same category of trade regime rather than simply trade agreements falls the system of the CMEA, especially in its early stage before 1956.

Bilateral clearings varied not only across countries but also within the same country across trading partners. Their variety is well documented by the League of Nation's survey. In some cases the clearing agreements referred exclusively to payment for goods, in other cases they included settlement of commercial or other debts. Different institutions – central banks, special offices, monopolies, effected the

[3] On the postwar bilateral trade arrangements see Patterson, and Polak, 1947. They demonstrate the difference between the German and Central European bilateralism in the interwar period and the agreements signed after the Second World War in Western Europe. The latter provide for «flexible clearing methods, for capital movements and for transactions with third areas» (Patterson and Polak, 1947:133).

clearing operations; some clearing agreements were more liberal and permitted a limited amount of “private compensations”.[4] Others were stricter and excluded this option; they were often linked to other commercial, financial or military arrangements; some agreements used a fixed exchange rate for a long period while in others exchange rates were subject to adjustment; the bureaucratic formalities for the importer and exporter varied significantly, depending on the type of goods traded and the partner country (League of Nations, 1935). The effects of bilateral clearing have also varied from delayed payments and adverse effects on exchange rates to prolonged trade dependence on a single partner (Ibid.).

Exchange controls are universally cited as the reason for the emergence of bilateral clearing but the practice of exchange controls is just as varied. Exchange control is broadly defined by Michael Heilperin as “the centralization of all dealings in foreign exchange in the hands of a public authority (a treasury, a central bank or an institution created *ad hoc*) (Heilprein, 1939:238 in Nenovsky and Dimitrova, 2007). Howard Ellis is more specific:

> Exchange control is understood generally to include any or all of the instruments dealt with below…:
>
> - Government monopoly of dealing in foreign exchange
> - Government disposition over private holdings of foreign exchange and assets;
> - Enforcement of an overvalued or an undervalued rate of exchange;
> - Multiple exchange rates;
> - Government permissions to export or to import;
> - Government disposition over the proceeds of exports;
> - Government allocation of exchange to imports;
> - Officially conducted bilateral clearing;
> - Officially conducted barter (Ellis, 1947:877).

Exchange controls served a number of purposes. With respect to the international economic matters they were used for the following:

[4] A private compensation deal between two companies is «an immediate offset of each parcel of export by an import of equal value.» (Ellis, 1941:15).

- To maintain exchange rate against depreciation or appreciation
- To attain equilibrium in the balance of payments
- To "permit trade to go on" without available foreign exchange
- To secure more favorable "terms of trade".
- To control or force capital movements.
- To wage economic warfare (Ellis, 1947:878).

With respect to domestic economic matters:

- To control inflation or deflation.
- To increase domestic employment.
- To foster industrialization etc. i.e. «protection».
- To prepare for or wage war.
- To provide revenue for the state.
- To discriminate favorably or unfavorably with respect to certain persons or classes within the domestic economy. (Ibid.)

Depending on the number of instruments and the purposes they served, exchange controls varied from mild to very strict. Definitions of exchange control are contingent on the duration and reasons for their use and they may appear somewhat *ad hoc* on a case-by-case basis. In the case of British clearing Clayton, 1935 defines it as follows:

> Exchange control can be considered as an extension of the principle of wartime rationing. There is a scarcity of the means available for making payments and therefore purchases abroad are limited. As a result the central authority allocates these resources according to its own list of priorities, instead of leaving the selection of the needs to be satisfied to be determined by competitive bidding in the market. (Clayton, 1953:161)

This view originates from the British experience where exchange control It was introduced on September 5th, 1939 (A.J.B., 1944). British clearing agreements were not strictly bilateral; they were used for payments on goods only and were between the whole Sterling Area where the pound was freely circulating[5] and non-Sterling area countries. "[S]pecial accounts" of blocked sterling, which "could be only held or spent" facilitated the clearing transactions (Clayton, 1935:172). However, there were

[5] The Sterling Area comprises the British Empire dominions, colonies and mandates plus a number of sovereign countries, which followed Britain off the gold standard and fixed their exchange rates to the pound after September 1931. Those include Argentina, Brazil and the Scandinavian countries. The Sterling Area was the biggest multilateral clearing union at the time within which the British pound was freely circulating and served as its reserve currency; «payments between residents of the sterling area were free; payments between residents and non-residents were controlled.» (Clayton, 1935:164)

exceptions to bilateralism and multilateral payments were allowed in some cases. Control was not always centralized and some private clearing accounts were also allowed; the Central American countries used a group clearing account with non-sterling countries, which allowed multilateral payments between them. Clayton's conclusion based on the case of Britain is that exchange control does not necessarily lead to full bilateralism.

This means that the relationship between exchange control and bilateralism is not purely automatic but depends on government policy and intergovernmental negotiations. Exchange control is not a necessary condition for both trading countries. Free exchange countries can also be part of bilateral clearing agreements if they are interested in trading with an exchange control country under its preferred rules. Such examples are Poland's clearing agreements with Southeastern European countries, the British clearing agreement with Germany and Finland's clearing trade with the Soviet Union in the post-war period.[6] Bilateral clearing as an emergency mechanism for effecting commercial payments under exchange control was practiced by Switzerland, France and Italy in their agreements with Eastern and Northern Europe and with Germany itself. The Anglo-German clearing agreement concluded November 1st 1934, is an example of payment agreement under which German imports to the UK were not limited or controlled but British exports to Germany were limited to the proportion of German exports to the UK in order to maintain a stable balance of trade. (League of Nations,1935:25).

There are also positive evaluations of the exchange control mechanism. Paul Enzig disagrees with the position of the League of Nations Financial Committee the

[6] See Laurila, Juhani, "Finish-Soviet Clearing Trade and Payment System - History and Lessons" Bank of Finland, 1995.

exchange controls are in principle a deviation, and finds them a useful instrument in time of international financial disorder. He argues that their universal establishment would greatly reduce risks to which international trade is exposed, "eliminate the unnecessary gold movements, bring to an end the immoral activities of speculators…" (Einzig, 1935 as cited in Cahan, 1937:138).

It is a qualitatively different case of bilateral clearing agreements when they are practiced not as an exception but as a rule. A bilateral clearing regime is distinct from simply bilateral clearing operation in that it requires both parties to the exchange to adopt systematically the instruments of monetary and trade policy defined by Ellis, 1947 for the greater part of their international trade sector. A regime in other words would be a general practice and would require international cooperation.

It is important to note that John Maynard Keynes based his plan for the post-war financial system on the idea of International Clearing Union, which would "generalize the essential principle of banking, as it is exhibited in any closed system... This system is the necessary equality between credits and debts, assets and liabilities" (Keynes, 1941). His main argument for it was the elimination of accumulated trade imbalances. Compared to the alternative plan of Harry Dexter White, which proposed "producing international *liquidity* on the basis of reserve currency, backed by an International Stabilization Fund", Keynes proposed providing "pure means and measure for the multilateral *clearing* of current accounts in the form of a currency unit" (Fantacci, Amato, 2009:1). The two plans rested on two different conceptions of the role of money. Keynes proposed an international monetary unit with a primary function as a means of international exchange but not a reserve currency (the store of value function is reduced), whereas White proposed that the international financial system be based on a reserve currency (the store of value function dominates the means of exchange function of money). At the time of the draft Keynes was of course aware of the German clearing experience, and he referred to it in his proposal as “taking improper advantage of a payments agreement” (Keynes, 1941:6). Making this distinction between the two regimes was important.

As Karl Ritter writes «Germany has concluded more clearing agreements and has, unfortunately, had more experience with them than any other country» (Ritter, 1936:465). Bilateral clearing was the general monetary and trade regime in the case of Germany’s economic relations with Bulgaria, Hungary, Romania, Yugoslavia, Greece and Turkey between 1933 and 1939 and in the case of the Soviet Union trade relations with the socialist countries. In both cases bilateral clearing agreements constituted the dominant monetary and trade regime rather than a temporary measure. It was also a part of a broader foreign policy towards partner countries.

After the end of WWII the countries of Eastern Europe, which were formerly part of the German economic sphere, continued to trade with the new hegemon and with each other under the same bilateral clearing regime. The bilateral clearing regime was adopted as the official method of economic cooperation among socialist countries with the establishment of Council for Mutual Economic Assistance (CMEA) in early 1949. The similarities of these trade regimes will be examined comparatively in future sections for Germany in the period 1933-1939 and for the Soviet Union between 1945 and1956.

1.2. Different Political Ends

The similarity of trade regimes used by the Nazi and Soviet systems is puzzling against the background of different economic structures, political objectives *vis-à-vis* partner states and dominant ideological frameworks. It can be said that different political ends were pursued through similar economic means – the bilateral clearing regime. Different political ends here refer to different imperial projects, which were based on different ideas of what the end goals of these projects were. Different political hierarchies were organized reflecting different understandings of the economic and security relations, institutions and ideology. The mechanisms of control from the center to the periphery of these imperial systems also differed in degree. The Nazi empire ruled by means of economic relations, through bilateral trade agreements and offering trade-offs between economic gains and lessened political authority of the client state. The Soviet empire ruled by means of direct control over the political leaders, appointing at key positions in each country cadres loyal to Moscow (Janos, 2000:234).

1.2.1. International division of labor

While both Nazi Germany and the Soviet Union saw Eastern Europe as an extension of their empires, these empires were conceived differently in political and economic terms. The Soviet Union, itself under-industrialized in relation to Central Europe, saw industrialization as a way to achieve economic development and legitimize its political influence. Agriculture on the other hand was looked down upon and investment in it was discouraged in all countries following Stalin's plan for socialist economic development. For Stalin modernization meant intensive industrialization based on Soviet supply of raw materials and sales on the socialist market. Because the Soviet Union at the beginning of the post-war period was less industrialized than some of the Central European countries this policy had mixed effects. Thus many East European countries developed industries of "dubious comparative advantage" (Holzman, 1974).

Hitler, on the contrary, did not aim to modernize or industrialize the region of Eastern Europe. Partial modernization in the agrarian sector was achieved under

German trade dominance in the very underdeveloped economy of Bulgaria (Wien, 2007). But this industrialization was limited to the agricultural sector and only where it did not come into competition with German food processing industries (Einzig, 1941:13).[7] The international division of labor was in line with German interests – industrial core, the Third Reich and the agricultural periphery in South-Eastern Europe, which would export foodstuffs without the possibility of developing industries. According to Paul Einzig "Hungary and Romania were prevented from developing fruit canning and meat industries simply because it was Germany's interest that they should be at the mercy of German purchases of their raw materials" (Einzig, 1941:14).

In the German economic sphere the bilateral clearing trade between the core and the periphery before the Second World War and according to the New Plan for the post-war period was based on a pre-existing pattern of international division of labor. For the small countries, however, continuing the agrarian profile of their economies ran counter to their developmental aspirations. Germany was confident in its position as the "natural" trade partner of Eastern Europe. In a 1937 publication in Foreign Affairs Reichsbank governor Hjalmar Schacht states:

> East-European countries are predominantly agrarian. For them the German market is a matter of life and death. (Schacht, 1937:223)

As the dominant industrialized economy in the region, Germany was the only one that could respond to the needs of the underdeveloped agrarian countries, a relationship based on comparative advantage, complementarities and common interests. Even the postwar economic plans for Eastern Europe did not include

[7] The exports from the region to Germany were predominantly foodstuffs, grain, tobacco, fruit and vegetables and raw materials such as timber, oil from Romania and ores from Yugoslavia. Germany exported machines, including military equipment, chemicals, transportation vehicles and industrial raw materials.

industrialization but assigned a strictly agrarian specialization of the region (Aly and Heim, 2002).

1.2.2. Raw materials and autarky

However the region of Eastern Europe alone could not supply sufficient raw materials for the German industry and the Reich continued to protest the Versailles Treaty, which deprived it of colonies. Schacht's statement cited above was made in a publication addressing the American audience and explaining how the question of German colonies and access to raw materials is directly related to the question of European peace. The two conditions for solving this question and securing peace were openly declared:

> First Germany must produce its raw materials on territory under its own management. Second this colonial territory must form part of her monetary system. Colonial raw materials cannot be developed without considerable investments. [...] German currency system must prevail in the colonial territories, so that the required investment may be made with German credits. (Schacht, 1937:233-234).

These German demands were never honored in relation to its former colonies, but their logic was successfully applied to the region of South-Eastern Europe where control over the monetary system was assumed through the bilateral clearing regime. The four-year plan of rearmament announced by Hitler in 1936 envisioned a system where Germany integrated each trading partner into its economic sphere through bilateral clearing trade. The clearing bloc with Germany in the center was as a whole autarkic. In the context of the severe insolvency during the Great Depression "German autarky policy in the 1930s was largely a selective retreat from financial relations with the western powers" (Ritschl, 2001:326).

The post-war Soviet Union in contrast had no shortage of raw materials and based its economic sphere on cooperation among autarkic states within a political bloc. Large-scale programs of industrialization in the agrarian countries, regardless of their comparative advantage, were implemented. The labor force in agriculture declined from 79 percent of the total labor force in 1930 to 56 percent in 1960 (Janos, 2000:344, based on Berend and Ranki, 1974:306 and World Bank, 1980:75). Machinery, metallurgy and chemicals made up more than 50 percent of the industrial production of these countries (Janos, 2000:345).

Raw materials for industrialization in the socialist bloc were secured by the Soviet Union, which in turn bought the majority of industrial production. "The system envisioned by Stalin was a combination of self-sufficiency, which was the end goal of industrialization in the individual countries, and bilateral agreements between them. In the early years of socialism autarky was justified with the "expectation of an imminent new world war" (Ausch, 1972). This led to a very low level of product and sector specialization among socialist countries. The main argument against joining the Marshall Plan and behind the "advise" to East European countries not to join was that it threatened their autonomy.

The Soviet project was not one of economic integration based on comparative advantage but rather one of economic autonomy. Roberts, 1994 argues that:

> Moscow formally rejected the Marshall Plan because, among other things, it proposed central direction of European economic development and limitations on national economic sovereignty. Moscow's objections on these grounds were subsequently embodied in Comecon's character and purpose and all Soviet efforts in the postwar period to amend the essentially national-based character of the organization ended in failure (Roberts, 1994: 1383).

The American condition for granting financial aid under the Marshall Plan was that the European countries form an institution of their own for multilateral management of trade relations. This design was seen by the Soviet Union as a centralized institution for control of the economies of Europe, which aim to limit Soviet influence in Eastern Europe. This nation-based character of the economy does not mean that national sovereignty was fully preserved.

1.2.3. Ideology and institutions

The way in which Nazi and Soviet policies of economic cooperation were justified also differed significantly. Nazi practices remained closely in accordance with the legal framework of its political predecessors. Although celebrated by national socialist economists as "modern money", exchange controls were not a national socialist innovation (Muller, 1939 cited in Ellis, 1940:1). They were introduced in August 1931 by the government of Heinrich Bruening[8] as a measure against capital flight. Hitler's motives for maintaining the high value of the mark differed from those of Bruening but the forms of control were roughly the same" (Temin, 1991:581). Until 1933 the limitation of currency convertibility and the subsequent increase of clearing trade had a purely defensive purpose. After the Nazi ascent to power this system was used for manipulating trade and securing economic resources in an exploitative relationship with trade partners. In his analysis of the German exchange control Howard Ellis concludes that after 1933 there was no economic justification for keeping the exchange control so strict:

> "The institution persisted because it was an instrument *par excellence* of political power – political power not only over foreign states but equally significantly over vested economic interests within the country" (Ellis, 1940:132).

Most arguments in favor of the German expansion to the east and the building of *Grossraumwirtschaft* were based on economic motives and sought justification in a historical position of leadership and even responsibility toward the region of Eastern Europe. They rested on the view that big industry needs big markets unhampered by

[8] Heinrich Bruening was a Social Democrat chancellor of an emergency cabinet between 1930 and 1932.

national borders, which was in line with Gustav Stresemann's[9] vision that only a strong economy could restore Germany to a Great Power and regain its international reputation (Wright, 2002).

On the question of foreign policy the national socialist government maintained that their current policies were in line with the "normal" course of events and continuing the pre-existing trade patterns. The clearing system was presented as an emergency temporary measure imposed by the circumstances of the Great Depression. Announcing each step of their policy as the inevitable course under the circumstances, the German bureaucracy gradually transformed itself and the bureaucracies of partner countries into administratively managed economies all the while assuring that the controls were temporary.

Soviets, on the other hand, had an openly revolutionary approach to institutions, administrative personnel and enterprise managers framed by Communist ideology. Russia left the Gold Standard already in 1914 (Nenovsky, 2006). After its sharp departure from the tsarist regime the Soviet economy underwent a series of radical transformations. During the period of War Communism the idea of annihilation of money was brought to practice through massive money issuing by the Gosbank. This was conceived as an essential step towards building socialism but caused a huge monetary and economic crisis, famine and uprisings. They eventually reversed the course temporarily and led to the partial reintroduction of market institutions and the new currency, the gold-backed chervonets[10], under the New Economic Policy (NEP) 1922-1924. The NEP was followed by the first five-year plan in 1928 with the

[9] Foreign minister between 1923 and 1929 in the Weimar Republic and a co-laureate of Nobel Peace Price in 1926 for reconciliation with France.

[10] The Chervonets was 25% backed by gold and 75% backed by short-term bills. It had a gold parity of 7.74 gr. of pure gold, which was equal to 10 pre-revolutionary golden coins (Nenovsky, 2006:9).

chervonets still circulating alongside the ruble until the monetary reform of 1947.[11] With this second monetary reform in the Soviet Union the chervonets was abolished and the ruble depreciated at an official ratio of 10 old to 1 new ruble. Even this reform was undertaken with the class war in mind with the conversion rate for deposits varied according to the size of deposits. It was most advantageous for small deposits and least advantageous for deposits above 10 000 rubles (Alexandrov, 1949).

By the year 1947 the internal Soviet economic model based on collectivization, mass production and administrative allocation of resources was fully established. In the postwar economic planning within the CMEA East European satellites were seen as on the same path of economic development as the USSR and Soviet policies and institutions were transferred onto their economic structures. Collectivization of agriculture[12], nationalization of the financial and banking sector, building of large state-owned industrial complexes were imposed by the Soviet Union and local communist elites in a revolutionary effort to eliminate capitalist modes of production and exchange. Unlike the Nazi ideology, which remained a capitalist one despite its national socialist propaganda, Soviet ideology was an anti-capitalist, a communist one with respect to domestic and international economic relations. The way the Soviet Union exerted effective control over Eastern Europe was not through economic policy like the Reich did but through "the establishment of the political monopoly of communist party systems" (Janos, 2000: 231).

The relationship between ideology and economic organization in both cases was not a causal one, at least not in the direction from ideology or theory to concrete economic policies. The development of the managed economy was not theoretically

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[11] Stalin did not openly oppose the NEP and avoided any conflict with Lenin on this issue but a more careful reading of his statements reveals that he found the NEP compromising the end goals of socialism and the class war against the capitalists (Himmer, 1994).
[12] With the exception of Poland.

prescribed, nor entirely planned. As Balogh points out in a critique of British monetary policy during the war, “the Nazis and Dr. Schacht did not operate from a theoretical base but “solved problems as they arose” (Balogh, 1940:261). The economic institutions were not necessarily pursued consciously but they were arrived at spontaneously as the control spread to more and more spheres of the economy.[13] The approach was a pragmatic rather than ideological one.

For the Soviet Union there were certainly general guidelines for what the end form of economic organization should be with a concrete prescription for “collective” ownership of resources. But ideology served a “post-hoc rationalization’ explanation much more than the ‘ideological determinism’ explanation of the connection between ideology and action” (Bornstein, 1966: 74). Marxian ideology prescribes the following “elements of the post-capitalist economy: (1) nationalization of the means of production and exchange, (2) planning in place of the ‘anarchy’ of the market, (3) valuation of goods according to their labor content, (4) abolition of money, (5) liability of all to labor, and (6) distribution according to contribution in socialism, according to need in communism” (Bornstein, 1966:74). But these could provide little direction for administrators because “[s]pecifically Marx and Engels offer no advice on such important issues as the internal organization of production units and their coordination on a national (an international) scale” (ibid., 75). Ideology served a “directive” function – guiding concrete policies, much less than it served a “masking” function – “when ideological statements are made to deflect attention from current realities” or “authenticating’ – when policies or measures are justified by citing ideological doctrines” (Comey, 1962, cited in Bornstein, 1966:77). The ideologies of Nazi and

[13] Eucken attributes an important role to the full employment policy in Germany which in his view lead «accidentally...step by step» to administrative control of the economy.

Soviet expansion to Eastern Europe were first of all different and second, they did not directly prescribe action.

The bilateral clearing regime in the Nazi case was never formally institutionalized but advanced on the basis of incremental regulatory changes. In contrast the Soviet Union adopted a formal structure for the organization of international exchange based on annual plans for exports and imports in the framework of the Council of Mutual Economic Assistance.

1.2.4. Security

From a security point of view the level of autonomy the two core states granted to their partner countries also differed. It is precisely this difference that draws the line between a sphere of influence and an empire according to Lake, 2009. The partner countries of Germany, even though heavily dependent on German bilateral trade, still conducted independent security relations with third parties - an arrangement seen as a sphere of influence (Lake, 2009). The Soviet Union in contrast created an empire having full control over the external economic and security alliances of its satellites. The signing of the Warsaw Pact in 1955 formalized the coordination of military affairs in the socialist bloc thus making it a fully functional empire (Janos, 2000:235). This empire was not essentially of the type of nineteenth century European empires based on an industrialized core and a periphery, supplying agricultural and raw materials, but in line with the Russian tradition of absorbing territories into its core and promoting their development from within (Khodarkovsky, 2002).

1.3. Different Global Conditions

The same trade regime was adopted by Germany in 1931 out of economic necessity, in a very short time frame when all alternatives were already exhausted. This was not the case for the Soviet Union in 1949. Global economic conditions differed considerably in the two cases.

The Great Depression, which started in the USA in 1929, triggered different responses in different countries. Some devalued their currencies earlier and left the gold standard - Great Britain in 1931 and the USA in 1934; others remained on the Gold standard longer but conducted deflationary policy and limited prices, wages and growth – France, Belgium, the Netherlands and others forming the gold bloc; a third group preserved the gold parity but imposed strict exchange controls – Germany, Italy, Austria and others (Nenovsky and Dimitrova, 2007:11). For them devaluation was considered a highly risky option because of their recent experience with hyperinflation (Germany). Fixing the national currency at a lower level in terms of foreign currency was not preferred because it could have induced a new inflationary spiral. Thus as a result of the Great Depression three different monetary and exchange blocs replaced the global market and subsequently formed trade blocs around core countries.

The Great Depression quickly reached Germany in the form of short-term capital flight and declining foreign reserves. In addition its reparation burden following the Versailles Treaty put downward pressure on the value of the reichsmark. Following the announcement of moratoria of foreign debt in Latin America international lending was severely reduced. In May 1931 the collapse of the Austrian Credit Anstalt spread panic across the world, bank runs, rise of discounted government bills[14] and major insolvencies in Germany (Ellis, 1940:8). By that time the government was already fighting rising unemployment and a growing budget deficit and found itself in urgent need of foreign credit, which it could not secure. Within a month “the reichsbank had lost a billion reichsmarks in reserves and was approaching the limit of the 40 percent reserve requirement against its notes” (ibid., 9). According to Kindleberger, 1973 Britain was unable to lend to Germany although it realized the magnitude of the crisis and its potential political consequences. France, which had the highest gold reserves in Europe and was also the recipient of the majority of German reparations, was categorically opposed to the idea of financing Germany. The USA, the other relatively able creditor, did not have an articulated political interest in Europe yet and therefore did not extend a loan to Germany (Kindleberger, 1973). The intention of the Hoover Moratorium - allowing Germany to postpone payment on its reparations with a year, was to curtail the panic and to slow the depression. But it had in fact the opposite effect. For the “man on street” this was a sign of the coming greater catastrophe (Ellis, 1940:9). In this situation Germany was left with one option – the urgent introduction of exchange controls in order to stop the outflow of capital. Exchange controls were introduced in Germany on August 1st 1931 (Child, 1955).

Decreased liquidity in foreign exchange as a result of capital flight and insolvency were the primary reasons for its introduction. Under different circumstances Britain faced similar liquidity problems in 1939 when it followed suit. At the same time the “overvalued exchange rate of the mark required exchange control” (Temin, 1991:580),

[14] Ellis, 1940, traces the logic of the reichsbank to the old banker's rule to fight a bank run with continued payments expecting that this will restore confidence. The «willingness to convert credit into cash» in the circumstances of 1931 Germany meant that an equal quantity of foreign currecy was lost to foreign countries. (Ellis, 1940:9).

which in turn opened the way to bilateral clearing. Other countries in Europe also introduced exchange controls at around the same time as Germany for similar reasons. This rendered payments on German exports to them illiquid. «The «frozen» German commercial claims increased in a few months to nearly one billion reichsmarks.» (Ritter, 1936:468) The agreements were a way for Germany to enforce these frozen payments. After the 1933 Nazi ascend to power this regime was transformed from a currency defense mechanism to a tool of economic manipulation.

In 1949 the Soviet Union had no shortage of foreign currency or gold reserves. It was well endowed with natural resources, land and labor. According to the Paris peace treaty of 1947 the Soviet Union as a victor of WWII acquired all German assets and financial claims in Eastern and Central Europe as a way of reparations. The inflation, created by the war, was stopped by means of the monetary reform of 1947. Not withstanding the huge material and human losses that the Soviet Union bore in World War II, it suffered no financial crisis comparable to Germany in 1931. The conditions and reasons for adopting exchange control in Germany were not present in the USSR. In addition, both time and alternatives were on the side of the Soviets. They had two years between concluding the peace and shaping the new economic regime during which various negotiations were held with the leaders of the democratic West and the United States.

The alternative economic arrangement was cooperation with the western European democracies and accepting American financial assistance under the Marshall Plan. The Soviet Union position on this plan formed gradually, evolving from positive interest to rejection over a course of a few weeks. Announced on June 5, 1947 by US Secretary of State George C. Marshall, this plan aimed at the economic reconstruction of Europe – east and west, Germany included. The forms and institutions of this assistance were to be negotiated by the European countries themselves. After the foreign ministers of France and Britain decided to accept the proposal the Soviet foreign minister Molotov was invited to meet with them in Paris. Initially interested in the proposal, Molotov attended the meeting with a delegation of "nearly 100 advisers – a definitive sign of the seriousness of Moscow's approach to the talks" (Roberts, 1994:1375). The positive response of the Soviets was communicated to the East European countries and they were advised "to ensure their own participation in forthcoming Marshall Plan discussions (Roberts, 1994:1373). "Once they become aware that American credits were conditional on each country disclosing its economic circumstances and participating in a pan-European program, the Soviets left the meeting" (Dimitrov, 2011:171).

Initially, the East European countries were informed about the "areas of disagreement" between Stalin and the Marshall Plan and advised "not to emulate the USSR in declining the invitation" to the second round of discussions on July 12 (Ibid.). Molotov however did not attend the second meeting and soon after withdrawing from the Marshall Plan project, Moscow communicated to the East European countries to do the same. Czechoslovakia was the only one that had accepted the invitation by 9 July, but withdrew following a meeting in Moscow the next day. The rejection of the Marshall Plan was motivated by foreign policy considerations rather than economic calculation and was the first signal of a shift from a policy course of cooperation with the war-time allies to a course of isolation, "containment and, later, of carefully managed conflict" (Janos, 2000:230).

1.4. Similar Economic Means

Unlike a free trade regime where money is used as a means of exchange, store of value unit of account and where resource allocation and exchange follows a price mechanism, in a bilateral clearing trade regime the role of money is reduced to its function of a unit of account and a very dubious store of value. Currency inconvertibility introduced with exchange controls mean not only that money is no longer used as a medium of exchange in international transactions but also leads to commodity inconvertibility, government controlled prices and strict bilateralism in both Nazi and Soviet trade blocs. Commodity inconvertibility means that foreigners cannot freely buy or sell at the local market or in the local currency.

German exports in the 1930's were controlled by government-issued licenses and even if a foreign country had a positive balance of blocked reichsmarks it was up to the Reichsbank to allow its spending on German goods. Germany's trading partners however did not see the reichsmark as completely inconvertible because the exchange controls were proclaimed as temporary measures. Some East European countries were willing to accumulate positive balances in blocked reichsmarks expecting that the exchange controls would be lifted. The accumulated blocked reichsmarks, called "sperrmarks", were treated as a kind of reserve currency by Bulgaria and Hungary providing an incentive to increase exports to Germany even when these had to be financed by the exporting government. Romania and Yugoslavia avoided such expansionary policy (Neal, 1979).

In the Soviet Union "commodity inconvertibility" was imposed by the national plan – foreigners could not shop for local goods because this would interfere with the planned quantities and because the domestic prices did not reflect the cost of production. Prices on the domestic market had low nominal value but were heavily subsidized, therefore if bought domestically and exported, they would be sold below their real production cost. Holzman and others see domestic prices in the socialist economy as “irrational” while Kaser prefers the term “arbitrary”, maintaining that “the producer in the Soviet Union … operates within a framework which is arbitrary, not parametric[15] [but] … arbitrariness in no way suggests irrationality” (Kaser, 1970:94). Exchange rates were also fixed as a matter of principle. The exchange rates of East European currencies were fixed first to the reichsmark and later to the transferable ruble, while maintaining a *de jure* official gold parity throughout without convertibility clause. Prices of tradable goods were fixed in the case of Nazi Germany for up to a year and in the socialist bloc for a period of five years.

For the period 1944 to 1952 the US dollar was used as a unit of account in trade among East European socialist countries and the Soviet Union. When in 1952 the ruble replaced the dollar as the bloc unit of account (at a ratio to the dollar of 4:1) socialist countries had less incentive to accumulate positive balances in rubles. Incentives to export were low even after the introduction of the transferable ruble and the International Bank for Economic Cooperation (IBEC) in 1964. The transferable ruble was not convertible outside the CMEA, neither in gold nor in any other currency. Unlike the reichsmark in the 1930’s, the transferable ruble was not used as a reserve currency by the USSR’s trade partners. This was partly due to its inconvertibility and the lack of market for it. The transferable ruble had a gold content of 0.987412 grams of pure gold and IBEC’s capital amounted to 300 million transferable rubles (Wyaczalkowski, 1966: 188). Nevertheless it was not a parametric measure of value but an arbitrary unit of account. The inconvertibility of the ruble was a fundamental institutional feature, which did not depend on the availability of gold but on the

[28] By parameter he means an exchange ratio, «a quantity which is constant, as distinct from the variables, in a particular case considered, but which varies in different cases». (Kaser, 1970: 93).

preference of the government for a planned over a market economy (Ausch, 1972:159).

Both clearing systems as a result were strictly bilateral. Multilateral clearing in the German bloc was not allowed and in the Soviet bloc it was allowed only as an exception in the later stage of the regime's evolution. The currencies' lack of a parametric value made both the sperrmarks and the transferable rubles, acquired from exports to one country incomparable to the same amount of currency, acquired from exports to another country. For the mature clearing system of the socialist countries, Ausch finds that "the differences in the prices of identical products sold to various partners are much greater than those having ever occurred in the history of clearing agreements" (ibid., 79). It has been estimated that the "transferable ruble price of a given export good of one country may vary twenty percent or more depending on the country to which it is exported" (Brainard, 1980:122). While this is a common occurrence in market economies as well - "pricing to the market", in the case of socialist economies not the market but government negotiations determined the price differentials.

Strict bilateralism also meant that there was no central plan for the entire CMEA or for the German economic sphere in Eastern Europe. In the CMEA each country had a national plan and the coordination of those plans took place in the form of bilateral negotiations between pairs of countries but no country had the authority to assign economic specialization or quantity requirements to the individual countries. The idea of centralized planning failed immediately as soon as it was born. The proposal for supranational planning made by Nikita Khrushchev in 1962 were met with rejection by the CMEA member countries, Romania rejected it most furiously (Curtis, 1992).

The majority of investigations of the Soviet system of international trade begin with an analysis of the domestic sector and with the explicit or implied observation that while domestic economies remain under central planning there is only one way of conducting international trade - under bilateral clearing. The general understanding is that:

> …in the individual national economies the very existence of an economic system based on direct plan instruction *necessarily* involves such international economic relations, such a type of world market and world economy (Ausch, 1972: 12).

There are several reasons why centrally planned economies trade under bilateral clearing. First and foremost the currencies of all the centrally planned economies were inconvertible which thwarted automatic equilibrium at the international level. Unlike the reichsmark of the 1930's they were not seen as overvalued because there was no "objective" economic link between the prices of domestic goods, the prices of exports and imports and the exchange rate. In Ausch's words: "[t]he links between domestic and foreign prices has been severed" (Ibid., 76).

1.5. Puzzle and Research Question

It is an interesting question why did the two regional hegemonic powers under different economic constraints and having different visions about their respective empires in Eastern Europe adopt similar international trade regimes. The first hypothetical explanation is that they adopt the same international trade regime because they are both totalitarian systems. That would mean that domestic control extends to the wider sphere of influence and rules were transferred from the domestic to the international economic institutions.

It is true that both regimes undertook total mobilization of other economies – the Nazis for the purpose of war and the Soviets for the purpose of economic development. There is also no doubt that they both desired to extend their power at home and abroad. However, there are two objections to a "totalitarianism" explanation. First, we have concluded from the review of exchange control that it is not in itself a totalitarian institution. Ellis notes that the system was inherited by the National Socialists from "Social Democrat supported coalition governments after nearly two years of elaboration" (Ellis, 1940:1). It received the support of German trade unions, which "possibly under the influences of a vague apprehension of inflation, of a general hostility to foreign capital and of an underlying tendency towards *Planwirtschaft*, also formally demanded the extension of exchange control" (Ellis, 1940: 15). There is no doubt that in both Nazi Germany and the Soviet Union "politics took primacy over the economy" (Buchheim and Scherner, 2006:394) but their political will alone does not explain the specific form of economic relations. The fact that bilateral clearing is still used today by non-totalitarian states such as China, India, Turkey and others means that totalitarianism alone does not explain a bilateral clearing trade regime.

Second – there were sufficient differences in the domestic structures of the Nazi and Soviet economies. Temin argues that the Nazi government encouraged cartelization and big industrial units for the same reasons the Soviet Union organized trusts and syndicates - to acquire better control over the production sector, as bigger units are easier to subordinate to the government objectives. However, the tradition of big cartels existed in Germany well before National Socialism took to power.

In the Soviet Union production was standardized and output goals were set in quantitative terms. It was organized with no regard to efficiency, "enterprises were interested in using the greatest volume and the most expensive type of materials"

(Ausch, 1972: 46). The Nazi economy showed a relatively stronger preference for quality alongside quantity and able management was rewarded.

A debated difference between the two regimes is the existence of private property in industrial production in Germany and its complete abolition in the Soviet Union. Some argue that private property in Germany did not mean private allocation of resources - economic decisions were subordinated to the goals of the Nazi government; managers were controlled by means of terror and the threat of nationalization of their assets, thus no resources could be allocated according to the discretion of the owners unless they were channeled towards fulfilling government objectives (Temin, 1991). This kind of incentives structure in Temin's interpretation delivered the same results as the Soviet nationalization of industry did.

Recent research based on additional archival materials questions this thesis. Scherner, 2006 argues that private property in the German industry was more than just a nominal value. The Nazi state refrained from widespread nationalization and allowed the huge profits, generated from state orders, to remain in the manufacturing enterprises (Buchheim and Scherner, 2006: 391). Unlike the Soviet Union, where production was managed by the state bureaucracy, freedom of contract in Nazi Germany was generally preserved; the industry rarely took direct orders from the state (with a few exceptions, notably after 1943); different enterprises could compete for the quotas granted by the state; investment decisions and the production profile remained a choice of the enterprises, despite heavy state regulation and so did initiative to fulfill profitable state demand (Buchheim and Scherner, 2006). Entrepreneurs in other words did not "relinquish rational calculations of their *own* business affairs. Not denying the use of terror by the Nazi state, Tooze, 2006 also describes big business as a kind of willing partners to the Nazi government. Geotz Aly goes even further in arguing that not only big business but also the general population of the Reich benefited greatly from wartime occupation and economic exploitation of foreign lands and it is rather the welfare benefits than the threat of terror that secured the Nazi regime's unchallenged internal hegemony (Aly, 2008). This points to another difference between the two regimes – the effort to sustain the consumption levels in Germany as opposed to the restricted consumption and caused famine in the Soviet Union.

Both regimes used price controls to influence the economy. While prices in both cases were fixed in the Nazi case this was done "as a matter of expedience"; German prices were not to be fixed for good. Wage setting in Germany became "a task of public officials" (Scherer, 2006: 390). In the Soviet Union in contrast, prices were fixed permanently "as a matter of principle" in line with the assumptions of the labor theory of value (Temin, 1991).

Other common features were the large amount of public investment; the standardization of production and its large scale; the co-existence of plan and black markets;[16] and the use of administratively-set prices for indirect control of the economy (Ibid., 579). While households were unable to make private plans based on price estimations, the central authority would assign resources for consumption up to the statistically established subsistence minimum. Similarly, markets for certain goods or services did not clear in the sense that there was no competitive price-driven process of supply and demand equilibrium.

The two regimes can be brought under the same common denominator of administratively managed economies. What is characteristic for them is that they do not tend to a general equilibrium, like an exchange economy does (Eucken and

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[16] The black market often provided the only way to fulfill the official plans and avoid bottlenecks created by miscalculated allocation of materials. Based on statistics of previous periods, the plans could not cope with unexpected situations. The black market provided an opportunity for correcting these miscalculations.

Hutchinson, 1948). This is a frequent observation by scholars of the socialist economic system.[17]

Speaking of the difficulty in analyzing centrally planned economies (CPE) with the theoretical categories of the market economies, Holzman notes that the case of CPE is a case of "… disequilibrium rather than equilibrium economics. This is similar to the situation in the West during the 1930's and 1940's when it became necessary to analyze the effects of quotas, exchange control, bilateralism, and rationing" (Holzman, 1974:1). On the usefulness of standard economic theory for studying exchange control Ellis sides with Eucken based on the German experience:

> I am inclined to believe that the political and economic powers of the National Socialist state would regard the nice calculation of economic pros and cons with ironical amusement, knowing full well their complete irrelevancy (Ellis, 1940: 132).

Similarly to the Nazi experience, the Soviets dealt with international trade organization as it arose out of foreign policy circumstances rather than ideology, using the clearing system to integrate different disequilibrium national markets into a socialist world market. The understanding that the Communist economy is a different system, devoid of the price-mechanism, provides the standard explanation that communist economies can only trade with each other under the system of administrative allocation devised by the CMEA. There is simply no other mechanism of equilibrium at the international level when disequilibrium at the domestic level prevails.

However the central planning does not fully explain the continuity of bilateral clearing regime. Foreign trade between countries with administratively managed economies can proceed in different ways. Walter Eucken gives a few examples relevant to the German experience before the war and of East Germany:

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[17] See Holzman, 1987 and Bornstein, 1981.

> It might be that the central administration in country A is negotiating with the central administration of country B or with a single private monopoly organization, or with partial monopolies or oligopolies in B or that competition ruled in B's markets. Foreign trade will proceed differently in each case and differently also in accordance with the place of foreign trade in the total plan of A. The central administration may build its plans for foreign trade into the total plan from the start, or it may be concerned rather to plan on the basis of autarky, with foreign trade only having the role of smoothing out disproportionalities as they occur. (Eucken, 1948:185).

These policies were relevant for the German experience before and after WWII but also for the economic policies and institutions of the East European countries.

1.5. A Case of International Trade Regime Continuity

Tracing a causal relationship from the domestic economy to the international regime is not an invalid approach and in fact the majority of the studies of socialist international trade begin with the observation that due to communism in each country the bilateral clearing is the only possible mechanism of trade. Historically, however, from the point of view of Eastern Europe and the German Democratic Republic bilateral clearing in international exchange preceded communism. In fact the international trade sector was the first sector to b e brought under the full monopoly of the state already in the 1930's during capitalist economic structures and largely authoritarian political regimes. Therefore it is unlikely that Communist domestic structures are the single cause of bilateral clearing trade.

The novelty of the present approach is in seeing bilateral clearing not as an extension of the domestic economic organization into the international level but as a continuity of the previous international regime after the fall of the hegemonic power, which introduced it. Adopting this perspective, we again have to ask (and answer) why did the regime continue to operate. This leads to two rival hypotheses – continuity by emulation and continuity by persistence. Continuity by emulation or mimicking would suggest that the USSR consciously adopted the German methods; the policy was seen as a model to be followed systematically. Continuity by persistence would be a simple taking over the already established trade regime in Eastern Europe without granting it the implied or explicit value of a model.

Continuity by emulation is unlikely for two main reasons. First, comparing the domestic organization of the Nazi and the Soviet economies in the 1930's Temin concludes that the domestic planning of the Soviets emerged out of confusion. If it were not a strategically organized system it would be unlikely to assume that they had a plan or a strategy for their international economic relations. Foreign trade had lower priority on the Soviet political agenda than the domestic economy. Due to its vast size and abundance of resources it did not need to import raw materials and was cut from trade with the West for ideological reasons already in 1917. Unlike Germany in the interwar period, the Soviet Union had no colonial claim over East European economies.

Second, any similarities in economic planning between the Soviet Union and the West were vehemently denied and the advocates of such common features - immediately sanctioned. Every testament to the positive effect of planning in the West was severely punished even without making a direct comparison. A top Soviet Economist, Eugene Varga[18] was publically criticized for his 1946 book "Changes in the economy of capitalism as a result of the Second World War" which demonstrated that wartime planning had enabled capitalist governments to acquire control over the

[18] Eugene Varga (1879-1964) Marxist economist born in Budapest, minister of finance in the Hungarian Soviet Republic of 1919, after its collapse he fled to Vienna and then to the Soviet Union in 1920. He worked for the Comintern and for the department of trade in the Soviet embassy in Berlin 1922-1927. In the 1930's he was the main economic advisor to Stalin, very influential for the formation of Soviet foreign policy and in relation to the German reparation (Mommen, 2011).

economy and thus to “become more socialist”. His views implied that capitalism could be reformed and its internal contradictions could be overcome without a revolution, which was a serious controversy in the eyes of conservative Communist administrators, who insisted that planning was only possible under socialism. The author was pressured to deny his claims and to admit “errors of a cosmopolitan orientation” (Hahn, 1982: 92).

It is an interesting observation that the share of clearing trade in total trade for each of the East European countries remains constant from the 1930’s through the 1980’s. The share of German clearing trade exactly coincides with the share of Soviet clearing trade – for Bulgaria it is almost 60 percent. This shows that the relative isolation from the world market and dependence on the clearing system for each country did not change considerably between 1935 and 1989. It is also important to remember that during peace time these countries were independent states - in the 1930’s had a considerable degree of autonomy over their domestic economic organization and after 1949 over their national economic plans.

The present thesis argues that the continuity of the bilateral clearing system was to a great extent promoted by East European states themselves. This system offered in both the interwar period and the socialist period a way for countries to manage their international trade relations as a whole, to offer compensation in one export item for advantages granted in another, to strike deals for military equipment and political concessions in exchange for labor extensive exports at above world market prices. The bilateral clearing regime also aggravated the problems that brought it about in the first place. The currency inconvertibility became stricter and any attempt to reform the system was unsuccessful because it required restoring full convertibility and abolishing the plan, a regime change for which the socialist countries were not ready politically until 1990.

Conclusion

Despite the differences in ideology, domestic structures and the ways in which they planned to build their empires, Nazi Germany and the Soviet Union resorted to very similar international trade and payments mechanism with Eastern Europe, namely they built bilateral clearing trade regimes. This regime was used by Germany in the period 1933-1939 as a mechanism of peaceful economic exchange and as an instrument of economic exploitation during the Second World War. The Soviet Union adopted the regime officially in 1949 to 1956 and continued using it with some modifications until 1991. The regimes emerged out of different global economic conditions and domestic economic structures and they served different political goals *vis-à-vis* partner states.

While the German economic sphere was based on the industrial core – the Reich and the agrarian periphery in Eastern Europe and was planned as an autarkic bloc, the Soviets pursued industrialization and autarky in each country and exchange among them within a political bloc. Both regimes relied on foreign exchange inconvertibility, state monopoly of foreign trade, bilateral balancing of foreign trade and fixed but multiple exchange rates. While comparative historical studies of these similar trade regimes are very limited, it is often assumed that the two regimes are very similar by virtue of their totalitarian nature. However, their similarities as centrally planned or administratively controlled economies do not predict they should adopt the same international trade regime with other countries.

This extension of control is by no means automatic and its degree depends on the willingness and interest of each partner country. This is suggested by the evidence that the shares of bilateral clearing trade in total trade of East European countries remains remarkably stable between 1935 and 1989 with the relative trade share of Germany in the 1930's and that of the Soviet Union in the early postwar period being the same. Therefore the thesis presents the bilateral clearing trade practice in Eastern Europe as a case of institutional continuity from a Germany-centered regime to a Soviet Union-centered regime. It argues that the regime was carried over not so much from the domestic to the international sphere but from a previous international arrangement to the next.

The following chapters explore the hypothesis that domestic structure matters for the functioning of a bilateral clearing regime in this case and of international regimes more broadly. Continuity was achieved through the convergence of interests between the dominant and the subordinate states and the related to it convergence of institutions.

Chapter 2: Literature Review, Theoretical Framework and Case Selection

Chapter Two continues the discussion of bilateral clearing by focusing on the small states. These are Bulgaria, Greece, Hungary, Romania, Turkey and Yugoslavia during the period 1931-1939. First, I provide a working definition of small states, then I build a concise narrative of the economic positions, political relations with Germany, expectations and motivations for participation in the bilateral clearing trade regime, the degree of dependence on German purchases and supplies and the political choices these countries made regarding giving up authority to a big state. I review the debates on whether the German regime was a form of economic exploitation or provided opportunity for mutual economic gain; whether Germany abused the “normal economic practice” or acted rightly as the natural hegemon in the region.

The analysis rests on theories of hierarchy in international relations and the regime theory literature and sides with the explanation that economic hierarchy rather than economic exploitation defined the relationship of Eastern Europe with the German Reich. The selection of Bulgaria for a case study is discussed and justified.

The chapter is a synthesis of theoretical approaches to trade power and authority and a historical narrative of the bilateral clearing regime promoted by Germany and advanced with the active participation of the East European countries between 1931 and 1939. They are conceptualized as small states in a hierarchical relationship, which had weaker bargaining power *vis-à-vis* Germany but were nevertheless autonomous and willing to cooperate trade partners.

2.1. Definition of Small States in Hierarchical Relations

There is not sufficient theoretical consensus on what constitutes a small state. Attempts have been made at providing absolute definitions based on a threshold of measurable factors such as population size, GDP per capita or geographic area. In the security literature "minor powers" have been defined as all the countries that are not great powers, which are:

> "Austria-Hungary from 1816 to 1918; China from 1950 on; France from 1816 to 1940 and from 1944 on; Germany or Prussia from 1816 to 1918, from 1925 to 1945, and from 1990 on; Italy or Sardinia from 1860 to 1943; Japan from 1895 to 1945 and from 1990 on; Russia or the USSR from 1816 to 1917 and from 1922 on; the United Kingdom from 1816 on; the United States from 1899 on. Minor powers are all those states that are not on this list for the given years." (Krause and Singer, 2001:12)

This definition is obviously based on Smallness does not refer simply to geographic area or population size, which directly translate into military capability but it refers to the degree of influence on the international political arena and the value of economic resources available to policy-makers. Small states have very limited influence outside their borders. In terms of monetary policy typically, small states are not issuers of main currencies, do not perform international lending functions[19], nor do they design the international monetary system. In terms of international trade they are price-takers due to the relatively small amount of their exports as share of world exports.

In the context of political institutions small states are rarely found at the forefront of institutional innovation, rather they emulate the good practices of the leading countries.[20] They are recipients of international regimes, that is they comply with the rules of international exchange advanced by big states and have very limited power

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[19] There are exceptions - Switzerland, Hong Kong and others.

[20] With some exception here as well, inflation targeting was introduced by New Zealand in 1989 and adopted by the Bank of England and the Bank of Canada among others (Hammond, 2012:7).

to influence politics outside their borders. While in economic terms small states are vulnerable due to insufficient resources in political terms they are vulnerable to institutional change imposed from abroad or their domestic institutions are more dependent on external factors than the institutions of big states. Economic and political factors are interdependent. Economic underdevelopment is often seen as a “constant source of political weakness” (Georgieva, 1997).

As a result of political weakness, small states are susceptible to institutional change imposed from abroad. Small states in general do not have the capacity to isolate themselves from shifts in hegemonic power or to avoid taking a side in military conflicts. For example the twentieth century history of Eastern and Central Europe has seen a variety of political regimes from multiethnic empires, to nation states of monarchic, authoritarian, totalitarian and democratic kind, which were brought about largely by changes in hegemonic power rather than by truly domestic revolutions. Domestic factors were present but they alone were not sufficient drivers of social change.

For the purposes of the present study small states are defined in relative terms according to their economic and political “size”. Unlike economic “size”, which can be measured quantitatively as GDP per capita, political “size” is defined by the context in which it is exercised or in the course of a relationship, economic and political, between two countries.[21]

One such definition of small states is based on their ”inability to protect themselves either militarily or economically against encroachment by larger and stronger powers” (Mosser, 2001:64). A significant difference between big and small states is the level of authority they have over their own policy or the degree of

[21] For example Greece is a small state in relation to Germany but acts as a big state in its relations with the Former Yugoslav Republic of Macedonia.

freedom their choices represent. This does not mean however, that small states are constantly unfree. They often give up national authority over certain policy areas in exchange for economic benefits or political protection provided by a big state, which is seen as a legitimate influence or rule (Lake, 2009). This influence can be observed as change of the domestic structure of the small state understood as both state policies and economic conditions. The tradeoffs between allowing external influence and expecting certain benefits are what constitute the political choices of the small states in relation to a great power.

Such a relationship is hierarchical but not necessarily coercive. It can be based on the great power's authority and capacity to extract compliance without threat of violence.[22] Allowing foreign influence of domestic affairs is an external loss of authority, which in itself constitutes state policy. The thesis follows the neorealist assumption that "interdependence derives from state policies not the other way around, that is it exists because states allow it to exist" (Gourevitch, 1978:894).

2.2. The German Offer for Eastern Europe in the 1930's – Economic Exploitation or Economics in Hard Times?

The interdependence between Germany and the countries of Central and Southeastern Europe after the Great Depression developed within a hierarchical international regime, or a regime of bilateral cooperation between a great power and a number of small states. In order to define the relationship as hierarchical it has to

[22] Not all small states are equally ready to accept foreign hierarchy. Small but advanced industrialized and democratic states tend to absorb external economic shocks through flexible adjustments of their industrial policies and welfare states without changing their specific mode of industrial organization. On the cases of Austria and Switzerland, see (Katzenstein, 1984) and on small industrialized states in general (Katzenstein, 1985).

fulfill two conditions. First, despite the huge power imbalance between the countries, the dominant state should not resort to coercion for achieving its desired results. Second, a positive acceptance of the latter's authority by the small state should be demonstrated. The question is therefore did Germany force the bilateral clearing regime onto its partners, or did they adopt it voluntarily, based on the expectation to benefit from it. Apart from the expected benefit was there any other positive motivation for giving up authority to Germany?

The bilateral clearing regime raised debates in both economics and political science. For economists it was a qualitative break from the previous trade regime based on free movement of goods and capital and currency convertibility under the gold standard. Advanced by economic practitioners and policy experts from a classical liberal position, the discussion of the German trade methods was at first highly normative and policy relevant. British economists denounced German trade methods with Eastern Europe as a violation of the established practice of international trade for the purpose of gaining unfair advantage. As opposed to the previously reigning free capital flow and free trade under the gold standard the German economic cooperation with Eastern Europe was a new system of international trade and payments. However it was still discussed in terms of its economic efficiency and terms of trade, even though in the context of the clearing regime these theoretical concepts were irrelevant.

German economic policy in interwar Eastern Europe is the case in an important contribution to the politics of international trade made by Albert O. Hirschman in his *National Power and the Structure of Foreign Trade,* (Hirschman, 1945). He uses the example of German trade with small East European countries to theorize "the possibility of using trade as a means of political pressure and leverage" (Hirschman, 1945:v). In his reading "the Nazi party, had not perverted the international economic system, they had capitalized on one of its potentialities" (Ibid., vii). Hirschman defines international trade as a "political act" (Ibid., 13) 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 countries. These differences result in asymmetric gains from trade and trade concentration. The richer country is usually the one that has a more diversified trade, both in terms of partner countries and goods traded. The poorer country usually has its exports concentrated on the market of one 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 cent (Ibid., 30). Because the same nominal quantity of trade has a higher weight for one country than for the other, a dependency relationship occurs. This dependence is also conditioned on the dependent country's "willingness to accept economic (or physical) punishment" (Ibid., viii).

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. Hirschman's analysis is concentrated on understanding the effects of trade on political power while the sources of the trade regime are to be found in the deeper economic structures of the trading countries i.e. they are exogenous to his analysis.

The nature and motivations behind the German clearing regime have been a matter of debate since its emergence in the 1930s, which unfolds in three different generations. The first generation of the debate emerges concurrently with its subject matter. In a heated opposition to the German trade methods Paul Einzig's "Bloodless Invasion" (1938) sees this practice as exploitation of the small states. The clearing system is a mechanism to exploit the small and vulnerable agricultural countries of Eastern Europe, to extract resources without honoring the bilateral clearing agreements, to keep the economies of the agrarian periphery underdeveloped and to force them out of other international markets by re-exporting their products for hard currency at much lower prices. Einzig saw the bilateral clearing system as a way for Germany to entrap weaker states and then to behave as a predator. This mechanism was perverting the system of international trade introducing highly artificial methods to gain comparative advantage (Einzig, 1938). This type of bilateral trade "has been achieved not by mutual understanding between the two parties but against the wish and to the disadvantage of the weaker party" (Einzig, 1938: 48).

Likewise, Antonin Basch discusses the clearing bloc as an area "organized with the aim of attaining the greatest self sufficiency for the German economic empire" by means of totalitarian commercial policy (1943:2,3). He finds that:

> By inflating prices, Germany divorced the price level of these agricultural countries from the world market system, and, finally reached the position of being able to dictate foreign exchange rates favorable to herself (Basch, 1943:3).

Basch argues against the view that German dominance in Eastern Europe is justified by the agricultural underdevelopment of the region and that only Germany could provide a solution to the economic problems of these newly established European states with its "industrial resources and organizing ability, and most important - natural export market". Many scholars at the time shared this position.[23]

> The fact that one country is an important natural market for the products of other countries, does not automatically entail sole responsibility for organizing their economies. (Basch, 1943:2).

[23] See Guillebaud, 1940:449-60 and Cole, 1942 as cited in Basch, 1943.

It can be inferred therefore, that the debate on the German clearing system, from its very beginning, was essentially a debate about its economic effects on the small states. Early debates between Einzig, 1938; and Ellis, 1940; Benham, 1940 and Basch, 1943 "created an orthodox interpretation" of the German position as exploiting the small states (Ritschil, 2001:324).

This view persisted into the second generation of the debate during 1950s and 1970s. While the system is still seen as "a device for monopolistic exploitation of the market" (Child, 1958:150) the new question asked is if Germany really gained from this arrangement and how much. Estimating the German terms of trade was the preferred method of measuring gains from trade. Frank Child argues that Germany significantly improved its terms of trade through the clearing agreements. Kindleberger, 1973 shows that for certain targeted products such as Bulgarian tobacco and Romanian oil Germany offered higher than world prices but paid very low prices for other products that had little alternative markets. Where buying at lower prices compared to other importers, Germany offered to buy large quantities (wheat in both Romania and Bulgaria). Therefore, the aggregate terms of trade of Germany with individual Southeast European (SEE) countries cannot be qualified as advantageous or not. Therefore terms of trade can only be understood as an aspect of a broader economic and foreign policy in the region. This view echoes earlier arguments by Ellis that "the monopsonistic position, which Germany had created for herself by clever exploitation of the clearing agreements led to her having a monopoly in significant segments of her partners' markets" (Ellis, 1940:107).

Table 1. Terms of Trade.

Germany's Terms of Trade, 1928-1938

	1929	*1932*	*1934*	*1935*	*1936*	*1937*	*1938*
With Hungary	100	70	70	73	51	54	55
With Romania	100	28	33	45	50	43	19

Southeastern Europe's Terms of Trade with Germany, 1929-1937

	1929	*1930*	*1931*	*1932*	*1933*	*1934*	*1935*	*1936*	*1937*
Hungary	100	98	93	93	90	102	111	108	102
Romania	100	69	49	56	56	54	63	63	77

Source: Neal, 1979: 396, based on data from the Royal Institute of International Affairs, *South-eastern Europe, A Political and Economic Survey* (1939), p. 197. “Terms of Trade” is the ratio of the relative prices of a country’s exports to the relative prices of the same country’s imports. A number lesser than 100 means that the relative prices of exports is lower than the relative prices of imports or the terms of trade for the country have worsened. Respectively, a number higher than 100 means that the relative export prices are higher than relative import prices or the terms of trade are improving.

The table shows that German terms of trade with Hungary and Romania decreased after the conclusion of the clearing agreements with them – in 1934 and 1935 respectively; at the same time the terms of trade of Hungary and Romania increased with the German economic expansion east for the first time after the downfall of the Great Depression. From this evidence Neal, in line with Benham, 1940 conclude that Germany did not exploit its monopoly/monopsony position. Neal points out the “serious theoretical problems in measuring terms of trade under the conditions of bilateral clearing agreements” because “the calculated terms of trade under bilateralism are the product of funny money … because it was paid into blocked accounts of the country who issued it” (Neal, 1979:393).

The key aspect of the bilateral clearing in his view is the way the central bank of the smaller country handled its blocked accounts with the Reichsbank. He discusses the small states as active policy-makers who although unable to influence Germany directly had full control over their domestic economies and used monetary policy to stimulate economic recovery. The alternatives, they could choose from, were either to stop exporting until the accounts were balanced or to continue exporting and accumulating blocked assets expecting they would be eventually paid. In the latter case the government of the exporting country had to credit its exporters until they receive their revenue from the importing country.

Neal distinguishes between the expansionist policy of Hungary, Bulgaria and Greece, who refinanced their exporters to Germany in advance of available deposits from importers, and the conservative policies of Romania and Yugoslavia, who waited for the balance to clear[24]. The refinancing option, which was similar to issuing money backed only by the blocked Reichsmarks, was only available to countries that had an export surplus with Germany and sustained the high exchange rate of the clearing mark. The clearing system in Neal's interpretation "offered them the best means available for financing economic recovery" (Neal, 1979:393).

The renewal of the debate in recent years attempts to re-examine the exploitation hypothesis thorough econometric analysis of archival material. Albrecht Ritschl's analysis of the secret foreign exchange balances of Germany between 1938 and 1940 suggests that instead of exploitation of the small "German autarky policy in the 1930's was largely a selective retreat from financial relations with the western powers" (Ritschl, 2001:4). Ritschl gives a definition of exploitation as "Germany's ability to attract real resource transfers through the system of clearing accounts" and finds that the clearing mechanism alone was not able to extract real resources. "Only after military occupation of a given country … does exploitation in the sense of steadily growing foreign exchange deficit become clearly visible." (Ritschl, 2001:14) Additionally Ritschl finds that Eastern Europe was dependent on trade with Germany well before the First World War.

[24] On the domestic sources of these differences see Janos, 2001 and Grenzebach, 1988.

Similarly, Eichengreen and Irwin (1995) demonstrate that the bilateral clearing bloc contributed to the disintegration of the international trade system but not to a significant trade reorientation towards Germany. They also find that countries in the reichsmark bloc trade with each other and with the rest of the world less than their "other economic characteristics would predict" (Eichengreen and Irwin, 1995:3). This is attributed to exchange rate stability within the block and not to the bilateral clearing agreements.

In contrast, a less quantitative approach by Jonathan Kirshner analyses the bilateral clearing system as a form of exercising monetary power. Unlike exploitation in the case of military occupation "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" (Kirshner, 1995:277). Therefore, Kirshner argues, "monetary power should be the most potent instrument of economic coercion available to states in a position to exercise it" (Kirshner, 1995:31). In his interpretation 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 Germany's interest. This allowed for a silent extraction of wealth from the periphery to the core of the bloc. The more trade was being conducted, the higher the cost of exiting the bilateral relationship, due to the uncleared balances in frozen accounts that the small states accumulated (Kirshner 1995).

The mechanism of altering the interests of the small states in line with the interests of Germany will be demonstrated in the following chapters by demonstrating how the policy of the central bank towards exporters in a small country was congruent with the Reichsbank's most preferred way of financing its imports. All of the reviewed studies, which are based primarily on trade statistics, analyze comparatively the short-term economic effects of German trade relations with Eastern Europe. The present thesis contributes to understanding the long-term effects of these trade relations based on a single case study over time.

2.3. The Small East European States

There is extensive literature on the ends pursued by Germany through this trade policy but little research has been done on the positions of the smaller partners in the agreements. They are usually assumed as passive receivers of the German foreign trade rules. Wien, (2007); Ranki (1983); Grenzebach (1988), Berend (1986), Lampe (1986) are exceptions to this assumption. They study the positions, motivations and benefits from the clearing agreements derived by the smaller states as well as on their strategies of resisting German pressure.

The different small states in Eastern Europe had different levels of integration with Germany and adopted different monetary regimes. The reichsmark bloc, unlike the Sterling Area, was not an area where the reichsmark was freely circulating but an arrangement with a cartwheel structure with Germany in the center and all the East European states as the spokes, which did not transact directly with each other but used Germany as the clearing point. In Southeastern Europe Bulgaria, Romania, Yugoslavia and Hungary adopted different monetary regimes, which reflect among other things different preferences for integration with the German economy. The role of monetary policy in these cases is strongly related to foreign policy goals because in the context of the bilateral clearing agreements international trade and payments were decided at the state level alongside with monetary and foreign policy. Therefore

I approach the question of the monetary and foreign policy from the point of view of each state's degree of economic integration with Germany.

Economic integration can be measured by the share of Germany in the imports and exports of each country. The degree of influence over the economies of the countries, can be approximated with the level of the blocked reichsmarks in the accounts of each country at the Reichsbank, which would be proportionate to the commercial credit extended to Germany by them. The greater the negative trade balance that Germany had with each one, the higher the amount of blocked assets.

Table 2. Germany's Trade with Southeastern Europe, 1929 - 1938.

Germany's Trade with Southeastern Europe, 1929 - 1938
(in million reichsmarks)

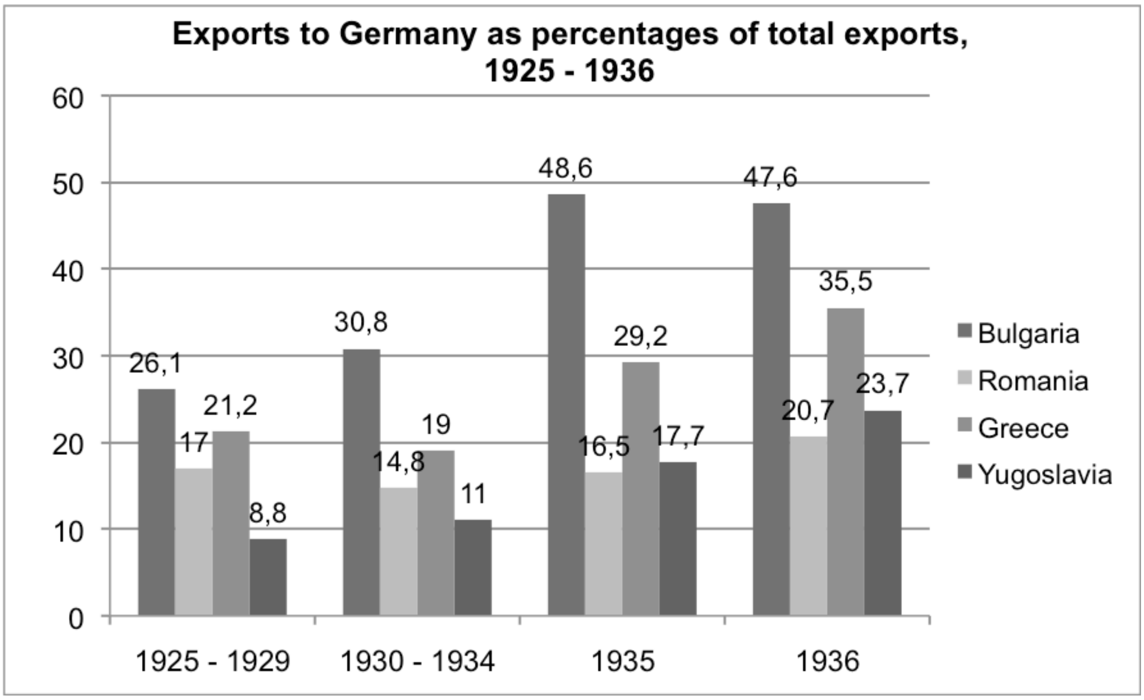
Bulgaria	**1929**	**1930**	**1931**	**1932**	**1933**	**1934**	**1935**	**1936**	**1937**	**1938**
Imports	51.2	58.9	48.3	34.5	31.3	33.7	41.4	57.6	71.8	84.3
Exports	44.7	22.9	25.3	20.8	17.7	19.3	39.9	47.6	68.2	56.4
Balance	*-6.5*	*-36.0*	*-23.0*	*-13.7*	*-13.7*	*-14.4*	*-1.5*	*-10.0*	*-3.6*	*-27.9*
Greece										
Imports	103.7	108.1	70.3	58.9	53.4	55.3	58.5	68.4	76.4	93.6
Exports	76.8	56.3	56.6	23.5	18.7	29.3	49.1	63.5	113.1	111.1
Balance	*-26.9*	*-51.8*	*-13.7*	*-35.4*	*-34.7*	*-26.0*	*-9.4*	*-4.9*	*36.7*	*17.5*
Hungary										
Imports	89.3	82.1	55.2	36.4	34.2	63.9	77.9	93.4	114.1	109.7
Exports	146.8	118.3	84.4	47.4	38.1	39.6	62.9	83.0	110.5	110.0
Balance	*57.5*	*36.2*	*29.2*	*11.0*	*3.9*	*-24.3*	*-15.0*	*-10.4*	*-3.6*	*0.3*
Yugoslavia										
Imports	60.9	74.8	40.1	29.5	33.5	36.3	61.4	75.2	132.2	107.9
Exports	152.6	172.1	95.1	43.3	33.8	31.5	36.9	77.2	134.4	118.0
Balance	*91.7*	*97.3*	*55.0*	*13.8*	*0.3*	*-4.8*	*-24.5*	*2.0*	*2.2*	*10.1*
Romania										
Imports	211.0	236.9	102.4	74.4	46.1	59.0	79.9	92.3	179.5	140.4
Exports	164.1	137.3	92.5	64.2	46.0	50.9	63.8	103.6	129.5	148.8
Balance	*-46.9*	*-99.6*	*-9.9*	*-10.2*	*-0.1*	*-8.1*	*-16.1*	*11.3*	*-50.0*	*8.4*
Turkey										
Imports	75.6	69.0	52.6	40.1	37.9	67.5	93.4	118.5	97.8	116.0
Exports	72.5	48.3	47.4	31.0	36.3	50.9	67.3	79.4	111.1	151.4
Balance	*-3.1*	*-20.7*	*-5.2*	*-9.1*	*-1.6*	*-16.6*	*-26.1*	*-39.1*	*13.3*	*35.4*
Total Imports	591.7	629.8	368.9	273.8	236.4	315.7	412.5	505.4	671.8	651.9
Total Exports	657.5	555.2	401.3	230.2	190.6	221.5	319.9	454.3	666.8	695.7
Total Balance	*65.8*	*-74.6*	*32.4*	*-43.6*	*-45.8*	*-94.2*	*-92.6*	*-51.1*	*-5.0*	*43.8*

Source: Ellis, 1940: 102.

The table shows that Germany had a generally negative trade balance with each of the countries and with the region as a whole. Trade as a whole increased after the initial drop in 1930 with both imports and exports surpassing the pre-depression level in 1937. The trade deficit of Germany with the region increased after the signing of the clearing agreements and was turned into surplus only in 1938.

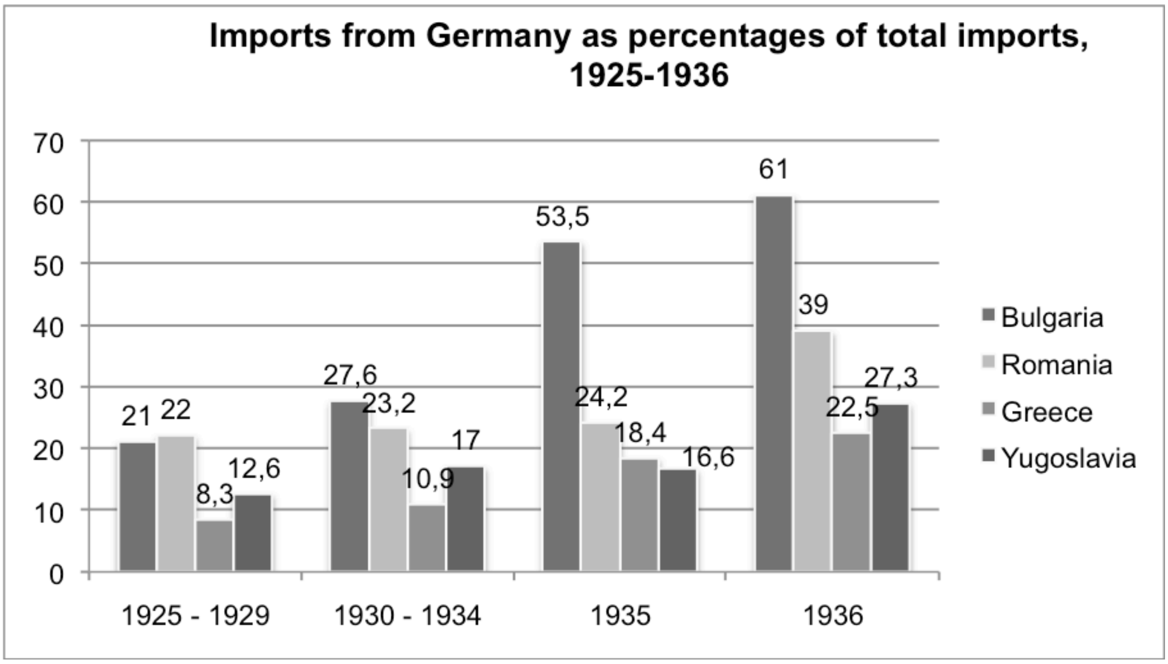
The share of German exports in the total exports of the In order of their degree of integration Bulgaria and Hungary were the most dependent countries on German trade while Yugoslavia and Romania resisted to a greater extent German economic penetration in to their economies. Turkey was the least integrated while Greece was along the positions of Bulgaria and Yugoslavia. This is partially evident from the following Charts 1, 2 and 3.

Figure 1. Exports to Germany as percentages of total exports.



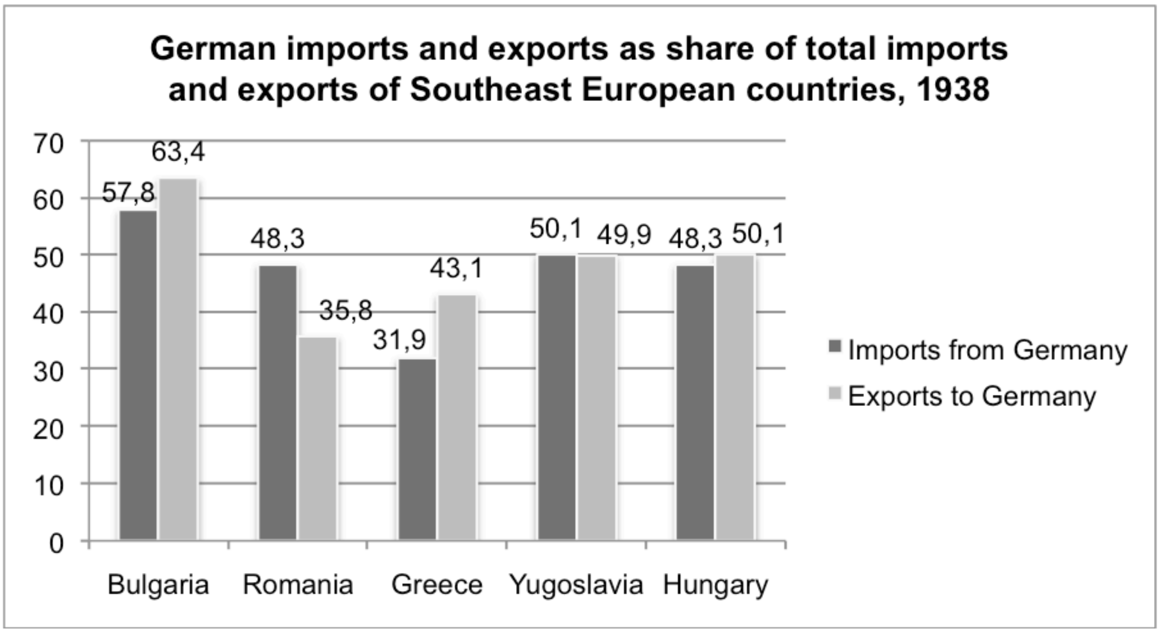
Source: Spasichev, 1936: 556.

Figure 2. Imports from Germany as percentages of total imports.



Source: Spasichev, 1936: 557.

Figure 3. Germany's share in the foreign trade of Southeastern Europe as percentages of total trade in 1938.



Source: Ellis, 1940: 111, based on Reichsdirektgesellschaft (Berlin, 1939).

By 1938 Germany had acquired trade hegemony in the region. It was the biggest single trading partner for all the countries but as evident from the three charts, Bulgaria was the most integrated with Germany country. What were the reasons for the different levels of trade integration and what were the alternatives to the German market for each of the countries in the region? Such alternatives were scarce because neither the great powers, nor the smaller states of the region could provide the necessary demand. As Janos, 2000 summarizes:

> Neither England nor France was in a position to be a viable trading partner for the region and especially not to act as the buyers of agricultural produce so vital for most of the local economies. After 1918 intra-regional trade fell to one-sixth of its pre-World War I volume (Hertz, 1970:83). Except for Czechoslovakia, the countries of the region could not find new markets in the advanced societies of the northwestern Europe. Indeed trade between those countries and most eastern countries fell significantly: from 46.6 to 18.8 percent of the total value of exports in the case of Hungary (ibid.), from 61.1 to 17.8 percent in the case of Romania; from 36.6 to 17.9 percent for Bulgaria. Yugoslav trade with the advanced capitalist nations of the Continent stagnated at around 10 percent of the nation's exports (Jackson and Lampe, 1982: 366 cited in Janos, 2000:201-2).

Both Spasichev and Ellis include Greece in the Southeast European region when they discuss the German clearing policy however Greece is not part of the Council for Mutual Economic Assistance and is not included in the present study because it falls outside of the research question of the continuity of the bilateral clearing regime. Turkey is a similar case.

Yugoslavia was highly integrated with the German economy during the 1930's and it continued to use bilateral clearing regime of trade after the end of the Second World War. The 1948 conflict between Tito and Stalin left Yugoslavia out of the CMEA arrangement. Unlike Greece and Turkey, Yugoslavia continued to use bilateral clearing regime with the CMEA countries. The growing German hegemony in Yugoslavia is traced in the following part.

2.3.1. Yugoslavia in the German economic sphere

Yugoslavia undertook a monetary stabilization policy in 1933 and fixed the dinar to the Swiss Franc at the level of 100 Dinars equal 7 Swiss Francs. Dinar's stability required also a restrictive fiscal policy. Clearing agreements with Switzerland, Belgium and France drastically declined in volume. Janos, 2000:202 quotes that trade with France was down to 2 percent of total Yugoslav trade while clearing agreements with Germany Italy and Austria – the main trading partners, enabled a growing trade flow (Gnjatovic, 2007:33). The initial clearing agreement with Germany was signed in 1934, which had the functions to enforce "the liquidation of a German credit balance of 100 million dinars" (Ellis, 1940:105). The clearing agreements maintained the export of key agricultural commodities - prunes, lard and wheat (Gnjatovic, 2007:48). After the League of Nations imposed sanctions against Italy, Germany quickly became the biggest trading partner in 1934. That year Yugoslavia had a positive export balance with Germany. Within the next year the clearing debt owed by Germany to Yugoslavia almost doubled. Table 3 shows its growth from 223 million dinars in December 1934 to 400 million dinars in December 1935.

Table 3. Germany's clearing debt with Yugoslavia, 1934 - 1938 (in million dinars).

Dec.34	Apr.35	Jun.35	Sep.35	Nov.35	Dec.35	Mar.36	Dec.36	Mar.37	Dec.37	Dec.38
223	300	260	320	362	400	465	327	415	177	400

Source: Ellis, 1940: 105, 107.

Figure 4. Germany's clearing debt to Yugoslavia, 1934 - 1938.

Source: Ellis, 1940: 105, 107.

Note: The values are different from the values for the trade balance, presented above in reichsmarks because the clearing debt includes commercial as well as non-commercial debts.

The official rate of the mark was initially 17.6 dinars for one reichsmark, “which admittedly overvalued the latter” (Ellis, 1940:106). The clearing balance of Yugoslavia kept at frozen account at the Reichsbank reached 14.6 million reichsmarks in March 1935. In the same summer the Yugoslav government permitted the sale of exporters’ clearing mark bills at a 4 percent discount rate but this did not improve the clearing balance. In November the discount rate increased to 15 percent, which in real terms including clearing fees and waiting periods without interest payments reached 30 percent (Ellis: 1940: 106). In 1936 private clearing was allowed and the Mark was set at levels between 12.83 – 14.50 dinars per mark as a result of improved bargaining position of Yugoslavia (Ibid.).

German trade policy in Yugoslavia included lower prices of German export items and higher prices of Yugoslav export items in the first two years. Purchases strategically included important items for the agrarian economy of Yugoslavia, like prunes and lard, which although not a priority for Germany, were purchased in big quantities in order to secure considerable amount of blocked assets. The price of Yugoslav lard after paying tariffs was 7 marks per 100 kilos more expensive than the price for American lard (Grenzebach, 1988). Imports were not compensating for exports due to low demand for German goods in Yugoslavia as about 80 percent of the peasantry was impoverished.

The German commercial policy was based not only on trade but also on active involvement in shaping the Yugoslav supply. Already in 1933 the German government sent a team of agricultural experts to Yugoslavia in order to “discuss the possibility of shifting agricultural production away from crops like wheat, which Germany did not need, to rapeseed, soya and other oil-yielding plants” (Glenny, 1999: 436). “Over the next year Yugoslavia agreed to offer Germany exclusive access to key mineral products - copper, lead zinc and bauxite” (Ibid.). In return Germany delivered finished industrial goods under the clearing system. It also offered diplomatic assistance against the Italian support for the Ustase and the breakup of Yugoslavia. It was more reluctant than Bulgaria but less resistant than Romania *vis-à-vis* growing German economic influence. It could be said that it adopted a flexible policy and managed to use the clearing system to its own advantage despite the dependence on Germany.

2.3.2. Romania in the German economic sphere

Romania resisted economic integration with Germany for the most part of the 1930’s. These relations were conditioned by Romania’s membership in the Little Entente, and traditionally in the French sphere of influence, which Germany viewed as a hostile alliance and was therefore unwilling to make any economic concessions to

Romania. Clearing agreements and the corresponding trade contracts were signed as late as March 1935 after long negotiations. Germany was interested in buying as much oil as possible while the Romanian government preferred to sell it on the free market in exchange for hard currency. But Romania was also predominantly an agrarian country and with more than 70 percent of the population engaged in the agricultural sector and need to increase its exports of wheat, which were of lower priority to Germany (Ranki, 1983:142-3).

The exchange rate policy of Romania went from a period of convertibility between 1929 and 1932 when the leu was freely convertible to gold coins, gold bullions and foreign currency convertible into gold to a regime of exchange control introduced on May 18, 1932 (Stoanescu, E. Blejan, B. Costache and A. Iarovaci, 2007: 244-254). The purpose was to prevent the devaluation of the leu. 90 percent of the capital of the National Bank of Romania (NBR) was private and the exchange control legislation was a state instrument directed against private banks and economic agents (Ibid.). The interest rate was kept high - in 1932 it was 8 percent later decreased to 7.

Alongside the exchange control exports and imports began to be regulated as well as of “October/November 1934 every import operation could be performed only on the basis of a previous export operation and imports should not exceed 60 percent of exports” (Ibid. 249). That was facilitated in a complex administrative way – exporters received import certificates issued by the customs authorities equal to 60 percent of the export value; authorized banks had the right to trade with these certificates and exchange them with importers. According to the initial policy, oil, wood, grain and vegetables were to be exported only for hard currencies. Where this was possible the exporters were paid an export premium of 10% in the case of oil products and 40% in the case of wheat (Ibid., 252).

Trade was based on the official exchange rate of 55 leu per mark until in 1937 it was fixed at a level of 38-39 (Ellis, 1940: 110). Ellis attributes this positive development of Romania's position to the recovery of the agricultural export prices (Ibid.). In 1938 as is evident from Einzig, 1938, Romania fixed the exchange rate to the reichsmark at a level of 39 leu per reichsmark but in 1939 fixed it at a lower level, to 44.74 leu per reichsmark. This gave Germany an advantage of 11 percent cheaper purchases than before (Hoisington, 1971).

The depreciation of the leu immediately decreased the value of the Romanian assets in the Reichsbank and also discriminated against other foreign buyers of Romanian goods such as France and Britain (Ibid.). According to the French ambassador in Bucharest, Jacques Lemaigre Debreuil, Germany's success to negotiate this level of exchange rate is a major victory for Germany against the Allies in every business deal with Romania. In this he saw the battle between the mark and the Allied currencies won by the Germans (Ibid.). According to the ambassador's views the reason why the Romanian government decides to allow stronger influence of Germany was their growing fear of the power of Russia in 1939 and not knowing about the pact between Russia and Germany they decided to signal a belonging to the German sphere of influence (Hoisington, 1971).

Although Romania was predominantly an agrarian state, like all countries in the region, it had the unique advantage of its petrol reserves. The political elite was predominantly focused not on the country's agriculture but rather on its nascent industry. At the end of WWI Great Romania had fulfilled its national goals adding within its borders Transylvania, Bukovina, Bessarabia and South Dobrudja and establishing a centralized government in the Old Kingdom. The national priority in the interwar period was industrialization based on its mineral resources or “economic emancipation by ourselves alone” (Roberts, 1951). This idea was promoted by the liberal party of Ionel Bratianu and later by his brother, Vintila Bratianu. It was dominated by upper bureaucracy, the banks and corporation boards, which created “an oligarchy of favoritism and corruption” (Rothschild, 1974) and had a Francophile foreign policy orientation.

The other major party, the pre-war Conservative party representing landed interests, understood industrialization as only a compliment to agriculture, which had the leading position. They lost support due to allying with Germany in WWI but gave rise to the National Peasant Party. The agrarian reform of 1921-23 which it promoted, was based on expropriation (often from non-ethnic-Romanians) and granting land as an entitlement for fighting in the war not following any logic of economic efficiency. The intended creation of a small-scale agriculture failed.

An important role in Romanian struggles for power played the bonus electoral law, which gives every party which wins more than 40% a premium of half the parliamentary seats plus a proportion of the remaining seats. It was used by both National Peasant and Liberal parties but as most countries in that period, the political parties were not only contenders for power in Romania. Royal figures through various forms of dictatorship exercised strong influence on the economic and political relations of their countries. In 1926 January 4th King Carol was excluded from the throne due to his ”irregular matrimonial life” based on the Exclusion Act. As a response he made his infant son Mihai heir of the throne and formed a regency council, which was dominated by the liberals. Their deflationary and anti-agrarian policy produced much discontent.

Averescu who was appointed prime minister on March 30, 1926 promoted "industrial autarky reduced freight rates and taxes on agricultural exports, negotiated an Italian loan, brought railroad administration under his own control" (Rothschild, 1974). On June 6, 1930 Carol returned and proclaimed himself king, eight years prior to establishing his Royal dictatorship and a new corporatist constitution on February 24, 1938. The militarization of Romania started in 1934 with an open campaign but unlike Bulgaria, no armaments were purchased from Germany until 1940.

Between 1923 and 1936 the foreign minister Titulescu pursued a successful balancing foreign policy between Russia, France and Germany. The oil fields in southern Romania remained free of German ownership while capital investments were welcome from British, French and American companies. At the time Romania was the "fifth largest producer of oil in the world and could sell oil at premium prices on the open market" (Glenny, 2000:453).

Capital in the oil refineries was distributed as follows: Romanian – 26.16 percent; English - 20.62 percent; Anglo-Dutch - 16.2 percent; American – 10 percent Belgian - 6.44 percent; Italian - 3.47 percent; German - 0.38 percent; other sources 0.57 percent (Agrigoroaiei, 2003, quoted in Sorin, 2008). Fifteen refineries functioned in the area of Ploiesti and in 1940 they employed 18 500 people (while in 1929 - 30,170) (Ibid.). In 1924 on July the parliament passed four laws on energy exploitation and mining effectively nationalizing the natural resources by restricting foreign capital and personnel. Later the law was amended to allow foreign investment in natural resources by the National Peasant Party in March 1929 (Roberts, 1951).

Economic nationalism played an important role in the Romania strategy for economic development. It framed their relations with Germany and was the main reason behind the decisive turn in 1938 away from the French sphere of influence and in closer cooperation with the Reich. Romanian oil resources and their geographical proximity to the Soviet Union were valuable assets from the point of view of Hitler's war plans. But given the political circumstances penetration into the Romania economy happened slowly and gradually. Similarly to its strategy in Yugoslavia, Germany made mutually beneficial deals with Romania by purchasing big amounts of its agricultural output together with the strategic for Germany imports of mineral resources. As documented by Ellis, "the treaty of March 23 1939 … Germany secured 25 percent of the oil production, the abandonment of grain monoculture in favor of specific German needs, the redirection of industry towards timber and oil processing and finally granting of free zones for German transit goods in the Danubian and Black Sea ports" (Ellis, 1940:110-111).

2.3.3. Bulgaria in the German economic sphere

The secondary literature identifies Bulgaria as the most dependent on Germany East European country in the period because Germany had the biggest relative share of its total trade; it kept the exchange rate of the reichsmark at a stable high level of 32.5 lev for a period of ten years; Bulgaria signed a bilateral clearing agreement with Germany already in 1932; it is often cited as the most economically backward country in the region after Albania. Lampe's 1986's account of the economic history of Bulgaria in the twentieth century documents the rapid economic growth rate of 2.7 percent for the period 1913 – 1950 which is twice Europe's average of 1.3 percent as well as a growth rate of 7.2 percent between 1950 and 1973. However, Lampe notes that the most rapidly growing export sector in Europe has been tied to a single buyer for a longer time than any other European country. This is one of the reasons it is a suitable case study for the effects of bilateral clearing trade on the domestic economy of a small state.

Bulgaria adopted an early policy of integration with the German economy with the signing of a general clearing agreement in the spring of 1932 between the Bulgarian National Bank (BNB) and the Reichsbank. The agreement facilitated the export of wheat and tobacco in exchange for deliveries of industrial products from Germany. The BNB had established a monopoly over foreign exchange in order to stabilize the currency with the Act N. 7840 for the regulation and limitation of the trade in foreign exchange of 12 December 1923. The regulation suspended all operations of the Sofia Stock Exchange, which was contributing to the currency devaluation; it also stipulated that all trade in foreign exchange was concentrated at the BNB; the foreign exchange acquired through export was to be sold to the BNB within 10 days of the acceptance of the documentation for its availability to the exporter at an exchange rate determined daily by the BNB; foreign exchange was also available for purchase only from the BNB at the daily exchange rate (Vladikin, 1929:101). As a result of this policy the exchange rate of the lev on the open market was sustained at the level of 27 levs = 1 Swiss Franc and 140 levs = 1 USD (Federal Reserve Bulletin, February, 1930, pp. 78).

Between 1929 and 1933 BNB issued a number of directives regulating foreign exchange transactions. The most important one was the October 1931 amendment of the Law for Trade in Foreign Exchange, which increased its centralization and made the BNB the only competent agent of foreign exchange transactions. The bank specified the items for whose import foreign exchange could not be purchased or used; it did not allow foreign exchange to be used for importing luxury goods and specified the period for which it had to make the foreign exchange available (usually three months after the import but it decided on exceptions for belated payments) (Petrov, 1933: 107).

These measures were heavily criticized by economists, who argued that the BNB had transformed itself from a Bank of Issue to an active regulator of the national economy (Todorov, 1932:19). Its regulations included a decrease in imports of raw materials to 50 percent of the imports in 1931, which was a serious blow to the local industries; it also regulated the quality of the imports and exports and decided on mandatory export under the compensatory deals i.e. bilateral clearing (Ibid.). Todorov, 1932 saw this policy as dangerous because it “[would] help the centuries-long aim of the western industrialized countries not to allow our country as well as all near-eastern countries to develop their local industries and to keep them at the level of lower economic forms of production where the western European industrial goods [would] have a market…they [would] manage the country as if it were an African colony” (Ibid., 20). The national bank was criticized for adopting a formalistic approach and not having consulted any economic and societal groups or experts before adopting this policy. It had assigned quantities of foreign exchange among different enterprises in a very formalistic manner. Rather than taking the mean of a longer period, it chooses a very short period for a base of the allowances. These distorting and randomizing effects actually punished the prudent businesses, who had decreased their needs of foreign exchange in accordance to the reality of the crisis and was rewarding those, who had contributed to the worsening of the balance of payments (Petrov, 1933: 107). The allowed quantities of imports were specified for each item category and it was strictly forbidden to import more of one item at the expense of another. According to the same author this shows that the aim of this policy was not only to regulate the quantity of foreign money in the economy but also to manipulate the structure of foreign trade (Ibid., 108).

The central bank also regulated the compensatory deals - contracts for the simultaneous exchange of goods for goods, similar to counter trade deals. The import of raw materials for the Bulgarian industry under the compensation agreements grew[25] at the expense of exports of ready industrial goods in which Bulgaria kept losing its competitive advantage (Ibid.). The products of local industry were intended for local use and priority for exports was given to agriculture.

The general clearing agreement with Germany was signed on June 24, 1932 in the context of falling export prices of cereal below the production cost, balance of payments deficit and attempts to artificially increase the prices of cereals by centralizing exports (Nikolov, 1932). Prices of export goods fell significantly more than prices of import goods for the period 1929 – 31 respectively with 62 and 28 percent (Petrov, 1933). At the same time money in circulation continued to decrease.

Table 4. Money in Circulation in Bulgaria during the Great Depression.

Year	Money in circulation *(in thousand levs)*
1929	3 608 643
1930	3 295 514
1931	2 894 074
1932	2 634 530

Source: Petrov, 1933.

Table 4 shows the continuous decline of money in circulation. Within four years this was almost 27 percent decrease.

[25] As a percentage of total imports the imports of raw materials for the industry were in 1931 – 20.74 percent; in 1932 – 22.52 percent; and in 1933 – 31.30 percent (Petrov, 1933).

The high interest rate of 9.5 percent (decreased to 8 percent in May 1932) set by the Bulgarian National Bank additionally restricted credit activity. As the general secretary of Bourgas Chamber of Commerce and Industry, Petrov, 1933 wrote about the need to reorganize and technologically modernize the local agricultural and industrial production, which were “in all respects backward”; he called for a consolidated state policy for securing export markets. He criticizes the local culture of economizing and saving and argued that it be replaced by creativity and a realization on the part of the peasants that their work is indeed a source of a better personal welfare and economic wellbeing (Ibid., 26). Increasing the level of productivity of the agricultural sector was not available to Bulgaria according to another economist of the time (Kamenarov, 1932:111) because the required investment was not available in a context of very limited and expensive credit, high level of taxation, creating unfavorable conditions for local capital formation and lack of foreign investment capital. Part of the policy of prioritizing agricultural exports over industrial ones was the specially established Export Institute (EI) and the agency “Hranoiznos” (Food export). The latter was a grain-purchasing board established to stabilize agricultural incomes (Tooze and Ivanov, 2011:46). In 1933 an explicit prohibition of import without the permission of the BNB was issued.

It is important to note that while the trade agreements with other countries – Hungary, Turkey, Poland, Romania and Czechoslovakia allowed for private compensatory deals and trade with Switzerland was exclusively based on private compensatory arrangements, the clearing agreements with Germany and the parallel trade agreement did not allow for private compensatory arrangements (Kalinov, 1936:212). The quantities and prices were not negotiated by private exporters and importers but by the respective government institutions of the two countries.

Bulgaria fixed the exchange rate of the lev to the reichsmark already in 1932 and kept its parity unchanged for ten years. Different premium payments, based on this exchange rate were granted by the central bank for the export and import of specific goods, which in effect created a system of multiple exchange rates.

In 1936 the Bulgarian government started using its frozen mark account at the Reichsbank for purchasing military equipment for its rearmament. These were mainly old tanks used by Germany in the First World War that had low value and no alternative buyer who would pay in convertible currency (Koen, 1979). Bulgaria is seen as the most dependent state by Ellis, 1940 who quotes the secret agreement with Bulgaria for the delivery from Germany of goods for which Germany itself had spent hard currency to purchase abroad, the so called "colonial" goods like coffee and cotton. While this looked like preferential treatment at first, it further isolated Bulgaria from the world market and in 1938 Bulgaria it was required to pay 25 percent of its German imports in free currency (Ellis, 1940:108).

2.4. Theoretical Framework

The relations between big and small states and their outcomes can be approached with two alternative explanatory frameworks – one based on power or another one based on authority. From the definition of small states, adopted in the beginning of this chapter, it follows that such relations are by definition hierarchical but not because of certain characteristics of the international system, rather based on specific relations between a dyad of states. A suitable framework for the study of hierarchy would be one that is focused on process rather than structure.

The concept of hierarchy arises from the discussion of world order and the nature of autonomy in the international system. While classical International Relations theory assumes that states are autonomous and therefore relations between them anarchic, hierarchy-based approaches assume that authority is divisible. The international system is still anarchic in the sense that there is no global government but from this it does not follow that relations between a dyad of states are always horizontal. In fact, with the exception of politics among great powers, the relations among states are often hierarchical. Hierarchy defines a relationship of unequal authority rather than of unequal power. Hierarchy is not necessarily grounded in power but it "exists when one actor … possesses authority over a second actor" (Lake, 2009:51). "Weather entered into voluntarily or through the pain of battle, it is the shift in decision-making authority from the subordinate to the dominant polity that defines the degree of hierarchy" (Lake, 1999:32). "The greater the range of actions of the subordinate that the ruler can legitimately regulate the more hierarchical is their relationship" (ibid, 62).

States can give up some authority over a certain policy area in exchange for expected benefits in another, typically a trade off between security and economic relations. David Lake defines several degrees of security and economic hierarchy. From low to high security hierarchy he distinguishes between "diplomacy", "sphere of influence" and "protectorate" and from low to high economic hierarchy he defines "market exchange", "economic zone" and "dependency". Combined symmetrically the economic and security hierarchies result in "informal empires" and "empires". (Lake, 2009:53). In an informal empire the "subordinate polity[26] cedes decision-making authority over foreign policy and areas of domestic policy to the dominant state;

[26] Polities are defined by Lake as "any organized political community that has or could have a history of self rule" (Lake, 1999:18).

subordinate polity conducts relations with others on the basis of sovereignty" (Lake, 1999:28).

This shift of decision-making authority can be observationally equivalent to dependence between a peripheral and a core state although arrived at in different ways. According to dependency theory the level of economic development of the subordinate state is a function of its weaker power position and its disadvantageous place in the international division of labor. It is a result of its place in the international system and has a permanent or rather deterministic effect on development. Hierarchy on the contrary is a relational concept, which is based on authority and not power.

What separates authority from coercion is the self-restraint of the dominant state. It limits its own power in order to secure compliance at a lower cost as opposed to securing it through the threat of violence. In the post-war liberal order US hegemonic power is restrained through international institutions, where voting rights are extended to weaker states. The power of the hegemon is restrained by means of international law. In the 1930's Germany voluntarily restrained from economic exploitation of Eastern Europe for reasons of reputation. Had it abused its position of power *vis-à-vis* one partner state, it would have discouraged other partners' cooperation. Sending the right signal to its trading partners was an important part of its practice. Reputation sustained through practice is therefore relevant and separate from power as an explanatory factor. "Authority is a political construct created and sustained through practice by a ruler and a ruled" (Lake, 1999: 20).

As discussed by David Lake (1999; 2009) Cooley and Spruyt (2009) the relationship between the domestic structure, understood as both state policies and economic conditions, and international superstructure, is an outcome of hierarchical relations. “What distinguishes authority from other forms of power is not the result - [small state’s] compliance but the mechanism through which power is exercised” (Lake, 2009:21). Coercion and authority can be observationally equivalent i.e. they cannot be differentiated by the outcome they produce. A way to resolve this problem is by undertaking a rigorous case study of the interactions between the states and studying their mechanism rather than their results. What this thesis aims to show is that hierarchical relations in the case under review were based on expected economic or political marginal gains in the context of a “political struggle as both the ruled and ruler contest at the margin the rights and duties […] of their relationship” (Lake, 2009:20).

Another important feature of political authority, which distinguishes it from coercion, is that it allows for choice. “In an authority relationship individuals chose weather to comply with the ruler’s commands, but are bound by the right of the ruler to discipline or punish their non-compliance” (ibid, 18). While Lake refers to “ruler” and “ruled” and “dominant” and “subordinate” state he is not concerned with the legalistic relationship between the two categories. Hierarchy is neither defined by the formal relations between states, nor is it “a prerequisite for political order” (ibid, 25). It is “a variable defined by the authority of the ruler over an increasing number of issues otherwise reserved to the ruled” (ibid, 45).

This set of definitions assumes that a case of hierarchy in international relations necessarily has to comply with at least two conditions. First, the option of choice should be available to the ruled weather to comply with the demands of the ruler or to accept a legitimate negative consequence of non-compliance. Second, the source of authority can only be revealed by tracing the process of interactions and cannot be inferred from the structural position of the small state in the international system. In a hierarchy approach it is important to demonstrate through a detailed case study what constitutes authority, what makes hierarchy attractive to the subordinate state and what are its motivations for participating in it.

In the case of a less powerful state the possibility of choice is not always obvious. In the absence of counterfactual evidence it is difficult to observe directly that an alternative policy choice was available. Nevertheless, “states are indirectly signaling that they recognize the authority of the dominant state when they fail to make efforts to diversify their alliances and trading partners” (ibid, 76). Lake provides a set of indicators for security and economic hierarchy and estimates their correlation. Indicators of security hierarchy are 1) the presence of military forces from the dominant state on the territory of the subordinate state and 2) the number of independent alliances possessed by the subordinate state (ibid, 68). Indicators of economic hierarchy are 1) monetary policy authority and 2) relative trade dependence measured as total trade with the ruler/GDP of the ruled (ibid, 68,71).

The hierarchy framework has certain similarities with regime theory, namely the source of authority or the legitimacy of the regime depends on the limited power of the state, which supplies the regimes. Regime theories claim that in order “to bind others the US had to bind itself” while Lake’s take is that “dominant states will tie their hands [in order to] sustain international authority” (ibid, 131). Germany also committed similar acts of self-restraint by foregoing opportunity for economic exploitation and granting certain economic concessions to the countries of Southeastern Europe. The Soviet Union is also found to have purchased loyalty and political compliance with economic subsidies to the six people’s democracies.

The question of continuity of bilateral clearing regime in Southeastern Europe is analytically similar to Keohane’s 1984 enquiry into the continuity of liberal world order after the relative weakening of US power. He argued against hegemonic stability theory, which predicts a decline of cooperation after hegemony is weakened. His critique, as well as the broader regime theory scholarship, explains the persistence of liberal global order with the persistence of “principles, norms, rules and decision-making procedures around which actors’ expectations converge” that is the persistence of an international regime. The value of this approach is the emphasis on behavior rather than distribution of capabilities and shared norms and institutions rather than simply power[27].

Regime theory is not a suitable theoretical framework for studying the continuity of trade regime across different ideological regimes because it puts a strong emphasis on norms and values. The norms or values drastically changed from the Nazi to the Soviet regimes, while the principles and rules of international trade with friendly states remained unaltered. The absence of normative continuity between the Nazi and the Soviet Regimes, makes this case ill suited for fitting the definition of regime. What the thesis studies, therefore, is the continuity of principles from one regime to the next, while the norms (*i.e.* the broader ideological justifications for the regime) are changing. For the sake of simplicity, I use the term “bilateral clearing regime” to refer to the common principles of balanced trade and bilateral payments, and the terms “Nazi” and “Soviet Regimes” to refer to the political regimes.

Ernst Haas defines regimes as resulting from “perceptions of interest“. In this sense, regime theory and hegemonic stability theory share the assumption that a dominant self-interested state provides or imposes a regime while bearing the costs associated with its functioning (Haas 1982). They differ in their expectations after the

[27] These theories emerged in order to explain global rather than regional order and they assume a global absolute hegemon, nevertheless, their assumptions are not incompatible with cases of regional hegemonic order or an informal empire. Scaling down the scope of the theory increases its explanatory power.

decline of the hegemon. Hegemonic stability theory predicts the end of cooperation, the inter-war period being one example of an "after hegemony" situation in international political economy literature. The disintegration of the world market after the Great Depression is a confirmation that global hegemony is necessary (Kindleberger, 1973). Regime theory, on the other hand, predicts that cooperation is possible through the functioning of an embedded international regime, although this is by no means guaranteed.

New institutionalism explains continuity by arguing that once institutions are created they can autonomously facilitate cooperation. Regardless of how institutions emerge - as a result of rational choice or in a path-dependent way, by "institutions" it is understood formal institutions, international organizations and bureaucracies in general. In the case I am researching the formal institutions are also subject to discontinuity, while the process of cooperation is continually facilitated by the same rules and procedures. Although I focus on the role of the central bank in the small state as the main agent of international dependence and a channel for policy change, I do not explain the continuity of the regime with the specific bureaucratic practices of the central bank. The central bank facilitates institutional convergence between the dominant and the dominated political regimes but it does not in itself carry the bilateral regime forward to the post-war period.

The concept of hierarchy is used in the context of Europeanization of Central and Eastern Europe. Andrew Janos discusses the post-Communist transition of the small East European states as "a process of transition … not from authoritarianism to democracy but from one international regime to another" (Janos, 2001:222). The term "regime" implies a hierarchical relationship of sub- and super ordination" which does not exclude the use of force. All regimes, domestic and international alike, are hierarchical although “international ones vary with respect to purpose, organization and legitimacy” (Ibid, 2001:223). Janos compares the Communist and the post-Communist international regimes and claims that despite the differences in purpose, organization and legitimacy they share “the role of external power in setting and enforcing political agendas for the states of the region and thus [influence] domestic political outcomes” (Ibid.) While equating hierarchy with power Janos does not see authority as a legitimizing factor for the relationship. What determined the outcome of external imposition of domestic institutions were “the level of pre-Communist economic development and the nature of the political culture” (ibid, 228). It is unclear though if these outcomes legitimated the international regime as seen by the subordinate polity as a whole or if they legitimated a centralized economy and served the narrow interest of the Communist party bureaucracy.

In the case of post-Communist transition Western hegemony, much more in line with Lake’s argument is seen as “soft” hegemony, relying on the trade off between economic restrictions and expected political gains in order to “co-opt the societies of East Central Europe into the existing institutional framework of the larger liberal commonwealth” (ibid, 236). Janos sees the European Union (EU) and the Soviet Union as sharing a common method of imposing domestic political change on the region based on “institutional uniformity”. That is through promoting in the client states the same institutions as the hegemonic state.

Concepts of soft power and reputation have been employed in explaining various institutional continuities in Eastern Europe. Gross, 2010 has worked specifically on the relations between Germany and Southeastern Europe in the interwar period and argues that the high reputation of German culture has been used to extend a network of educational, business and information ties between

Southeastern Europe and Germany in order to increase German economic and political influence in the region. His analysis is at the level of sub-state actors such as trade fairs, business association and research institutes and builds on a richer concept of authority, which encompasses the role of private economic, educational and cultural organizations for making German trade partners credible and attractive to Balkan business elites. This effort was in line with the German government's imperial ambitions for building an economic bloc with South Eastern Europe after the collapse of the global economy and the use of soft power was an effective tool for reaching this goal (Gross, 2010).

There is no shortage of evidence that the Soviet Union also used cultural policy in order to legitimize its rule in the region (Janos, 2001). These detailed case studies of soft power are important illustrations of Lake's concept of authority and how it achieves subordination at a lower cost than coercion. Similarly, the analysis of monetary power by Jonathan Kirshner finds that the concealed power embodied in the monetary institutions is especially effective in relations with politically friendly states (Kirshner, 1995).

The thesis demonstrates that while big states used soft power and political reputation to induce compliance with their preferred rules, small states have positive motives to participate in them and are under certain conditions in a position to extract benefits and balance trade offs. It also demonstrates that continued subordination to foreign rules and requirements creates a political culture of legitimizing foreign authority, and fosters a political tradition, which prioritizes foreign to domestic sources of political change. The small state is simultaneously a client of the big state and an agent of domestic interests, which enables the continued operation of the regime even across different hegemons. This is an argument for the agency of small states, which explains their position not with the determinism of their subordinate economic position but with their own political goals and aspirations.

The thesis thus uses the case of Bulgaria under the German clearing regime and then under the Soviet international trade regime, embodied in the CMEA in order to demonstrate this hypothesis on a least likely case. The degree of dependence on the hegemonic state as approximated by the share of trade with that state in the total trade of the small state, is highest in the case of Bulgaria among all Southeast European countries. Under a clearing system of international trade this means that Bulgaria had the highest relative share of trade controlled by the hegemon. In the case of Bulgaria the unintended consequences of the Nazi plan for economic expansion to the East was the provision of a well-functioning institutional design for international economic exchange with the Soviet bloc.

The countries in the region used the bilateral clearing regime to a different degree and these degrees remained relatively stable in the pre- and post-war period. For Bulgaria the share of clearing trade in total trade was about 80 percent before the Second World War (Christophoroff, 1939) and the clearing trade with the members of the Council for Mutual Economic Assistance was roughly 80 percent for the entire period of socialism (van Brabant, 1990, cited in Hillman and Milanovic, 1992).

Table 5. Shares of CMEA trade and USSR trade in total trade of socialist countries.

Shares of the CMEA in Trade of Member Countries; Shares of USSR in trade of member countrues, 1989 *(percent)*						
	CMEA in Total		*USSR in CMEA*		*USSR in Total*	
	Import	*Export*	*Import*	*Export*	*Import*	*Export*
Bulgaria	83	73	79	74	66	54
Czechoslovakia	54	55	57	54	31	30
GDR	42	38	57	58	22	24
Hungary	32	32	62	56	22	24
Poland	35	32	60	56	21	18
Romania	40	55	58	59	23	32

Source: Hillman, Arye L., and Branko Milanovic, eds. 1992: 221. *The Transition from Socialism in Eastern Europe. Domestic Restructuring and Foreign Trade*. World Bank Publications.

The thesis argues that this dependence was neither a mechanistic result of structural factors, nor the inevitable outcome of German imposition. While it is true that under German demand Bulgarian institutions adjusted and rules were transformed in accordance with the German demands, it is also true that the Bulgarian state gained unprecedented control over the economy. This control was not in itself socialism but rather a regime of administratively managed economy, a state corporatist type of economy, which in turn produced more state regulation and more centralized control. The continuity of the bilateral clearing regime does not imply that socialism was already present in the late 1930's. The economy in the 1930 was still a capitalist economy and the means of production were privately owned. The following chapters demonstrate that state monopoly of international trade and payments was the institution sufficient for the continuity of the bilateral clearing trade regime. The method used is detailed process tracing within a single case over two different periods of time. It combines a historical narrative with theoretical concepts in order to analyze in detail a policy-making process and a mechanism of granting authority.

Conclusion

The chapter defined the scope of the thesis as the political and economic trade-offs before a small state faces framework of a hierarchical relationship with a big state. It defined small states; introduced key concepts and the main theoretical approach, which follows Lake, 1999 and Lake, 2009 understanding hierarchy not simply as power but as a willing giving up of authority over some policy are to a greater power. It reviews existing debates on the role of the German economic sphere in Eastern Europe and gave examples of individual countries' motivations for cooperation and resistance to economic integration with Germany. It defined the continuity of the trade regime as the relative stability of the shares of bilateral clearing trade as percentage of total trade of the Southeast European countries and of the shares of Germany and the Soviet Union respectively which are of relatively equal value. Finally the chapter defined Bulgaria as a case study for the following chapters based on it allowing the greatest degree of trade dependence on Germany and the Soviet Union respectively.

Chapter 3: Bulgarian-German Relations – Foreign Sources of Domestic Institutions

This chapter analyses the introduction of exchange controls in Germany and Bulgaria during the Great Depression and the subsequent establishment of bilateral clearing trade agreements between the two countries. The deep changes of the monetary and trade regime in Bulgaria will be analyzed through a historical study of the role of the Bulgarian National Bank (BNB) in channeling international monetary relations. The BNB was responsible for implementing *ad hoc* adjustments to the changing international trade rules imposed by Germany. Increased state control and centralized decision making in Germany forced the gradual spread of state control over international trade in Bulgaria. During this period Bulgaria developed a high level of dependence on the German market and continued to be dependent on the clearing system to a similar degree in the postwar period. This chapter provides a historical explanation of how such dependency occurred; it traces the motivations and interests behind the Bulgarian government's decisions and the short-term effects on Bulgarian domestic institutions.

Bulgaria experienced both external loss of authority and internal strengthening of state control. The principal-agent relationship between the German and the Bulgarian government as a result of which the Bulgarian state became the main allocator of resources and the main negotiator of international economic exchange. This chapter uses archival documents from the Bulgarian National Bank, which trace institutional development under the pressure of constantly changing German rules of trade. Other sources include published academic journals of the period 1929-1944 as well as secondary sources on the topic.

3.1. The Great Depression in Bulgaria and Germany

Between 1929 and 1932 Bulgaria suffered an outflow of short-term foreign capital and a fall of prices of agricultural exports, which were its main source of foreign currency. Declining foreign currency revenues created a balance of payment problem. In addition Bulgaria was a debtor country with obligations of up to around fifty percent of the national income in 1932.[28] Between 60 and 80 percent of total trade of Bulgaria was conducted with Germany with a predominantly positive trade balance for the entire period until 1944. Under bilateral clearing this meant that Bulgarian revenues from export were not paid in convertible currency but kept in blocked accounts at the German central bank, which could be used only for government-approved counter-purchases in Germany. In managing these frozen accounts the Bulgarian National Bank (BNB) made efforts to stimulate the domestic economy while allowing it to become heavily dependent on German purchases and deliveries.

From 1929 to 1930 the value of exports decreased from 3500 million levs to 3340 million levs, while the quantity of exports increased from 138 000 tons in 1929 to 318 000 tons in 1930[29] (BNB 2004:193). That means that a 145 percent increase of the volume of exports led to a 4.6 percent decrease of exports revenue. Despite the drop in export prices the trade balance was still positive through August 1931, but

[28] Author's calculations based on national income data by Chakalov, 1946 cited in Rangelova, 2000 and foreign debt data in Krystev, 1932.
[29] The numbers are for the first seven months of both years 1929 and 1930.

from September 1931 onwards the trade balance started to deteriorate. Export earnings reduced by half between 1929 and 1933 (Lampe 1986). At the same time massive withdrawal of short term foreign capital up to 2 500 million levs depleted the foreign exchange of the BNB (Avramov 1999). Table 6 shows the rapid decrease of foreign exchange reserves at the time of the Great Depression, which caused a considerable depreciation of the lev against gold, expressed in its declining gold coverage.

Table 6. Foreign Reserves of Bulgaria, 10.1929 - 02.1930.

	Gold and Silver	Foreign exchange	Coverage
	(million levs)*		%
1929			
October 31	1552	1222	42.55
November	1555	846	39.74
December	1558	911	42.70
1930			
January 31	1566	506	40.22
February 28	1570	352	38.16
Increase (+) or decrease (-) Feb. 28, 1930 compared to Oct. 31, 1929			
	+18	-870	4-.39

Source: Avramov ed. 2004. *The Bulgarian National Bank: A Collection of Documents*, the Central Public Records Office, Vol. 4, 1930-1947, p. 189. * The annual exchange rate to the US dollar is 143 levs in both 1929 and 1930.

Even though gold and silver reserves were relatively stable, the rapid depletion of foreign currency reserves was 870 million levs in five months or about 6.09 million US dollars. In 1931, in order to avoid devaluation of its recently stabilized national currency, Bulgaria introduced exchange control, which further restricted international trade and opened the way to the bilateral clearing agreement with Germany.

Table 7. Foreign reserves, gold coverage ratio and trade balance, 1927 - 1939.

Year	Total reserves (in million levs)	Coverage ratio (in percentages)	Trade balance (in million levs)
1927	13078	28.3	489
1928	12897	31.2	-810
1929	8984	42.2	-1928
1930	9249	37	1601
1931	8620	36.6	1274
1932	7519	35.8	-88
1933	7442	36	644
1934	7278	35.3	287
1935	6549	34.4	244
1936	7158	33.8	729
1937	8196	31.9	34
1938	8250	31.8	644
1939	11677	29.9	868

Source: Statistical Yearbooks of the Kingdom of Bulgaria (1934, 1937, 1941) in Dimitrova, K., N. Nenovsky and G. Pavanelli, 2007:19.

The crisis aggravated the longstanding underdevelopment of the economy characterized by agrarian overpopulation, low purchasing power of the urban population, small scale agriculture, low productivity and profitability, low degree of marketization and high indebtedness of the peasant population (Daskalov, 2005). One protectionist response to the widening price scissors was the introduction of import tariffs for agricultural products. These tariffs had a negligible effect, as it was still much cheaper to import American wheat. The importation of wheat in what had once been the granary of the Ottoman Empire was a huge blow to the national sentiment and a sign of serious crisis.

In an emblematic speech at the Bulgarian Economic Society on December 3rd 1931 Alexander Tsankov, an economist and a former prime minister of Bulgaria, described the crisis as “ubiquitous, deep and lasting.” Tsankov foresaw the crisis as ushering a possible transition to a new political system where state control would be the rule. Amidst the uncertainty whether the new system would be Communist, fascist or a new kind of capitalist system he stated:

> By looking at life nowadays we can see that the state is increasing its influence and control over all spheres of life (Tsankov, 1932).

Cholakov (1932) agreed that a stronger involvement of the state was the main outcome of the crisis. In order to protect the value of the national currency the state assumed monopoly over foreign economic and monetary activity, which is seen as the first institutional change of socialist type adopted well in advance of the socialist regime[30].

In Germany the initial adoption of exchange control on 1 August 1931 was also a policy of defense of the mark's exchange rate. Capital flight was a common problem, concurrent with the increasing unavailability of international lending after a number of debt moratoria were announced in Latin America (Kindleberger, 1987). Among the three policy alternatives: devaluation of the mark, foreign debt moratorium or exchange control Germany opted for the latter.

In its initial phase German exchange control was seen as a comparatively liberal regime where penalties were not too severe and restrictions applied to sums above 20 000 reichsmarks only (Child, 1958). However, in 1933 and 1934, with the implementation of the Nazi four-year plan, exchange controls became stricter, penalties for evasion higher and control extended inevitably to trade and other economic relations with foreigners (Ibid.). The governor of the Reichsbank and Minister of the Economy Hjalmar Schacht officially announced the changes of monetary and trade policy in September 1934 as the "New Plan". The initially

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[30] Hayek's idea of the "slippery slope", initial regulation leading incrementally to greater state control and eventually to a socialist type of state, finds empirical support in the case of exchange control and bilateral clearing agreements. This contribution differs from the slippery slope argument because it focuses on the external influences on domestic institutions and trade as a specific channel of institutional change (Hayek, 1944).

defensive currency stabilization mechanism was transformed into an active regulatory regime mobilizing resources at home and abroad for the needs of the German government.

3.2. Establishing Bilateral Trade Relations Bulgaria - Germany 1931-1932

Exchange control was introduced in Germany on 1 August 1931 (Child, 1978), a decision with which Berlin took the path towards domestic credit expansion, autarky and trade diversion away from its principal creditors (Ritschl, 2002). Bulgaria introduced exchange control on 15 October 1931. The German-Bulgarian bilateral clearing and trade agreement was signed on 24 June 1932. According to this agreement the Bulgarian National Bank opened an account in levs in the name of the Reichsbank and the Reichsbank respectively opened a reichsmark account for the Bulgarian National Bank in Berlin. Imports from Bulgaria were paid for by German importers to the Bulgarian account at the Reichsbank. Exports to Bulgaria were paid from the same account. Payments were to be cleared in reichsmarks between German importers and exporters. What crossed national borders were goods and notifications between the central banks but no foreign exchange. The clearing agreement of 1932 had a clause stating that on the last day of the month the corresponding clearing accounts, if not in balance, should be compensated according to the average exchange rate of the Reichsbank in Berlin (Central Public Records Office, Sofia. F 285 K/5/80).

Exchange control in Germany meant “a monopoly of the Reichsbank of all foreign exchange transactions. It was entitled to buy all receipts of foreign exchange and to be the exclusive foreign exchange seller” (Child, 1978). Child describes the initial exchange control in Germany as an institution for the defense of the mark and a comparatively liberal regime, where penalties were not as severe and restrictions applied to sums above 20 000 reichsmarks only. In 1933 and 1934, with the implementation of the Nazi four-year plan, exchange controls became stricter, penalties for evasion higher and control extended inevitably to trade and other economic relations with foreigners (Ibid). This reorientation of monetary and commercial policy was officially announced in September 1934 by Schacht as the “New Plan”. Thus the initially defensive currency stabilization mechanism was transformed into an active regulatory regime.

Exchange control in Bulgaria initially was a reaction to external pressures rather than an active tool of foreign economic policy. With a new regulation of 17 October 1931 the bank acquired the right to stop operations in the foreign currency of any country imposing exchange controls. Export of Bulgarian lev was prohibited, foreign exchange was not allowed for the import of luxury goods or works of art. Local representatives of foreign companies were obliged to surrender their foreign currency commissions to the bank; individuals who held foreign currency could only use it with the permission of the bank and could not purchase new amounts before spending the available ones (Avramov 1999). This was an unprecedented monopoly of the BNB over foreign exchange transactions very similar to the one in Germany at least in its initial implementation as an anti crisis measure. Soon after its introduction the BNB control spread from the monetary sector to other spheres of economic activity.

Above all exchange control meant a fundamental change in the role of money. In the international sphere money lost its function as a medium of exchange and remained only a unit of account.[31] While the domains of production and domestic exchange property remained private and transactions relatively free, all international operations were nationalized as early as 1932. It is precisely the sphere of international exchange that enforced control over the private domestic economy.

Additionally three structural changes of the economy occur with this trade regime. First, for payment purposes, imports and exports were directed to the same partner country despite factors of demand, price or opportunity cost. The bilateral character of the trade relationship made it susceptible to political pressures and produced dependency on the state. Second, assets of foreign exporters were frozen and controlled by the local central bank which regulated their use through export and import licenses. Third, while exports are desirable from the point of view of economic growth and employment, trade surplus under the clearing system does not deliver the expected gains from trade in the form of foreign exchange. The more a country exported, the more blocked assets it accumulated at the partner country's clearing bank giving that bank more leverage over the allocation of these assets. Bilateralism arises from the non-convertibility of assets and is the point at which economic resources are being distributed rather than traded, the point of transfer from the domain of economic exchange to the domain of political bargain. These changes at the international level had lasting effects on the domestic sphere, which is demonstrated by the change in the role of the BNB in the 1930s and the functional continuity of the clearing institutions into the socialist system.

[31] Its role as a storage of value is also questionable because private accumulation of foreign assets was not allowed.

3.3. Growing German Influence

Once in control of the means of trade, the BNB soon extended its functions to controlling trade itself. This centralization, however, was not an inevitable outcome of exchange control. Different degree of centralization existed with different countries and across time. While trade with Germany was completely centralized by 1934, clearing with Switzerland was predominantly private. In principal bilateral clearing does not need to be centralized by the state and it can operate on private basis if merchants are allowed to manage their own blocked accounts in the partner country. This was a common practice in the initial stage of the clearing system where the central banks served merely as transaction facilitators.

The relationship between German interests and Bulgarian domestic policymaking is a complex one. The Bulgarian central bank's monopoly over foreign exchange can be seen clearly as a domestic economic policy in the context of the depression. But the role the bank takes in foreign trade centralization is directly influenced by changes in German trade regulation. One example is the October 5th 1933 Reichsbank prohibition of private offsetting between importing and exporting companies and imposed this rule on its trading counterparts (Central Public Records Office, Sofia, F 285 K/5/164 p. 442-444). In a letter to the BNB the Reichsbank's Directorate explains:

> In practice the advances received from the export of Bulgarian compensatory goods in Germany can no longer be transferred to a private bank account of the owner of the goods or to a company of his order. Nor can the exporter directly dispose with this sum but all advances have to be transferred to the Reichsbank in the account of the BNB and thus only the latter can operate with the sum. All private compensations are from now on to be channeled through the official clearing accounts (Ibid).

This is an illustration of how unilateral change in the German regulation triggers a change towards greater centralization and increased state control of the economy in Bulgaria. It also gave more power to the German authorities, which had the upper hand in negotiations. One immediate result was the accumulation of imbalances, due to the accounts not being cleared monthly as the official agreement prescribed. The BNB annual report for 1934 provides the figures of the growing blocked reichsmarks in the clearing account and the decreasing amount of available free foreign exchange. Despite the bank's efforts to secure a positive balance of payments the report states that realization of this aim depends on external factors (Ibid.).

As shown in table 8, the year 1934 saw a trade surplus of 305 million levs, which did not increase the foreign exchange position but on the contrary – caused a 20 million levs foreign exchange deficit. This was due to the growing share of clearing versus free trade (BNB Collection of documents Vol. 4. N 8426, p 224).

Table 8. Foreign Exchange Flows 1932 - 1934.

Incoming foreign exchange in million levs

Year	Total cambio	Clearing	Free Foreign exchange	Blocked Foreign exchange for internal transactions	Banknotes in blocked accounts	Compensations
1932	3544	684	2305*	-	271	320
1933	2778	1439	858*	-	250	231
1934	2859	1513	487	67	190	602

Outgoing foreign exchange in million levs

Year	Total cambio	Clearing	Free Foreign exchange	Blocked Foreign exchange for internal transactions	Banknotes in blocked accounts	Compensations
1932	3678	607	2613*	-	138	320
1933	2759	1301	1038*	-	189	231
1934	2879	1372	684	94	127	602

Note: * Including blocked for internal transactions
Source: BNB Annual report for 1934. N8426. in BNB Collection of Documents, Vol. 4 (2004), p 224.

Table 8 shows the dynamic of free and frozen accounts – the free account decreased considerably between 1932 and 1934 and the frozen asset rose almost two and a half times. Total cambio refers to foreign exchange in banknotes, checks and other bills of exchange issued and payable in foreign countries but traded locally. Clearing refers to the clearing accounts of BNB abroad; Free Foreign exchange refers to banknotes and bills of exchange resulting from non-clearing trade. Blocked Foreign exchange for internal transactions did not originate from international trade but from sale and purchase of foreign exchange domestically. Banknotes in blocked accounts are not necessarily generated by trade with blocked advances. Compensations are defined by Ellis as a bilateral arrangement, different from clearing, where "trade does not proceed against open book account involving a periodic balancing of all items, but rather an immediate offset of each parcel of export by an import of equal value." (Ellis, 1941:15) Compensations are similar to barter, they require that both importer and exporter must find the "double coincidence"; they do not allow for the liquidation of frozen claims but they allow for "departure from an artificial rate of exchange enforced in the clearings" (ibid.) Compensations were still regulated by the national authorities. Each deal had to be approved by the BNB and the Reichsbank; special permissions were issued for a limited period after which they would become invalid (Ibid. p 406). Export through a centralized clearing account was easier to achieve than through compensation.

In 1938 the size of the foreign exchange deficit was already 221 million levs, while the trade surplus had grown to 811 million (Annual Report 1938, N2630, 29 March, 1939. *Bulgarian National Bank Collection of documents* Vol. 4.: 261). From the 1938 BNB annual report it is evident that trade volume with clearing account countries had grown while trade with free exchange countries had declined (Ibid., 260). This means that a traditional source of foreign exchange is no longer available and the monetary value of exports is only an accounting tool but not an expression of monetary income.

As bilateral clearing gained force, the national bank justified its dominance with the lack of alternative markets for the low quality Bulgarian exports. The clearing regime was announced as appropriate for the national economy and established empirically by the bank's efforts to promote exports and to secure the local industry's raw material supplies (Bulgarian National Bank, 2004). Even though these can be seen as legitimate efforts, the very structure of the demonetized international trade limited the chances of the Bulgarian economy to diversify its trading partners. It also had an adverse effect on the domestic banks and credit institutions whose foreign trade operations were transferred to the national bank. The increase of exports resulted in a steady increase of blocked assets in the Bulgarian clearing account. Despite the agreement's provisions, regular balancing of the accounts was not implemented leading to a persistent positive balance with the only exception of 1937. (Table 9).

Table 9. Foreign exchange balance of BNB in million levs.

Year	Clearing Account			Free Account		
	Incoming	Expenditure	Balance	Income	Expenditure	Balance
1933	1 689	1 490	199	858	1 038	-180
1934	1 770	1 593	177	487	684	-197
1935	2 583	2 256	327	524	525	-1
1936	2 434	2 414	20	1 221	966	255
1937	2 644	2 855	- 211	1 336	1 264	72
1938	4 388	3 577	811	751	908	-157
1939	9 868	9 415	453	1 491	1 453	38

Source: BNB Annual report for 1938. *BNB Collection of Documents* Vol. 4 p 260.

Table 9 shows the dynamic of the clearing and free accounts. The clearing account shows a steady increase between 1933 and 1939 both on the incoming and outgoing side, which means that trade flow as a whole was growing. It also shows that with the exception of 1937 Bulgaria had a positive balance in the clearing account, which means it was exporting more than it was importing under the clearing agreement. The free account is less straightforward. Free trade was not completely replaced by clearing. Thus table 9 shows that in 1937, 1273 m levs worth of free currency was generated through export to free exchange countries accounting for 26 percent of total exports while in 1938 only 14 percent of total export went to free exchange countries generating 776 m levs in free currency. At the same time imports from free exchange countries increase in 1938 contributing to the negative free exchange balance of 157 m levs. The sharp dynamics of the free account are the result of the trade structure in place. The products Bulgaria exported to the free exchange market are mainly corn, barley, oat, sunflower seed and fodder while for the clearing market Bulgaria exported fruits and vegetables. Lower relative harvest of the free exchange exports versus blocked exchange exports was the cause of a negative balance of convertible currency.

The other source of free exchange was the free account with Germany. In May 1933 during his visit to the Reichsbank and the German ministry of Finance the governor of the BNB achieved an amendment to the bilateral clearing agreement allowing for thirty percent of the Bulgarian export revenues to be paid in free currency. The latter was transferred to a special free account, which could be used only for the purchase of raw materials imported to Germany and traded by German companies. The secret list of raw materials included cotton, wool, leather, rubber, iron, and other metals all used in the local industry. However, 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. This is evident from the difference between the owed and the transferred free exchange (Table 7).

Table 10. The Free account 1936 - 1938.

Year	Bulgarian Export to Germany and Austria *(in million levs)*	Available assets in the Free Account *(in million levs)*	Percentage of total trade	Total due = 30% *(in million levs)*
1936	1976	208	14	592
1937	2364	358	15	709
1938	3284	302	9	985

Source: Berov, 1979.

Instead of thirty percent in free currency Germany paid fourteen percent in 1936 and only nine percent in 1938. Even though Bulgaria’s bargaining position was not too weak *vis-à-vis* Germany, the power to enforce the free account clause lay with the German government.

The importance of Germany as a trading partner was growing both in terms of total trade and in terms of clearing trade (Table 6). Bulgaria exported agricultural goods and raw materials in exchange for German industrial goods and later on for armaments.

Table 11. The share of German imports and exports in total trade and in total clearing trade.

Year	Export Shares in percentage				Import Shares in percentage			
	Clearing in total Export	Germany in total Export	Germany in total clearing Export	Non-clearing in total Export	Clearing in total Import	Germany in total Import	Germany in total clearing Import	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

Source: Christophorov, Assen. 1939. Development of the Business Cycle in Bulgaria *1934-1939. Works of the Statistical Institute for Economic Research at the Sofia State University, issues 1-2 (in Bulgarian)* Sofia.
Note – For 1938 and 1937 export/import data refers to the first five and four months of the year respectively.

The first clearing agreement between the BNB and the Reichsbank was signed in the spring of 1932 (Berov, 1979). The agreement aimed to enforce payments to German exporters, whose revenues were blocked in Bulgarian bank accounts (Ibid., 306). The agreement was the following: the German tobacco firm Reemstma bought tobacco from Bulgaria for 50 million levs on the condition that at least 25 per cent of this sum be spent on future German exports to Bulgaria and the remaining 75 per cent covered the payments of old German claims (Ibid., 307). The clearing sums from the Bulgarian side were transferred to the Kreditbank, Sofia - a branch of a German commercial bank (Ibid.).

Together with the clearing agreement the BNB issued an ordinance for the regulation of private compensations. The list of export items approved by the BNB included fruits, vegetables, meat and animals, lard, coal, rose oil, tobacco, wine, rakia, dairy products, kaolin, sugar and wood. The designated imports from

Germany were medical supplies, petrol and its derivatives, salt, raw materials for the industry, iron, tin, zinc, other non-ferrous metals, rubber, machine parts and agro-chemicals. Bulgarian exporters of the above products could also clear old debts to German partners.[32] In May 1932 negotiations to increase the volume of the clearing agreement to 200 million levs failed and in July 1932 it was increased only to 200 million levs (Berov, 1979, 309). By August the same year however the amount was increased to 250 million which covered all German commercial debt that had been blocked in Bulgaria after the introduction of the exchange control. The compensation method unlike clearing required an immediate offset of private accounts with no outstanding claims, which is referred to as a hundred percent compensation. Clearing can be seen as less than a hundred percent compensation deal.

Bulgaria concluded clearing agreements also with Czechoslovakia (1932), Austria, Switzerland, Belgium, Poland, France, Yugoslavia and Hungary (1933), with Turkey, Spain and Italy (1934), with the Netherlands (1935). By the end of 1935 almost 80 per cent of Bulgarian foreign trade was concluded under clearing agreements, which was the biggest share of clearing trade among all the states in the exchange control bloc.

The turning point towards a Germany-dominated export structure was the so-called "Big tobacco compensation deal" signed on 31 August 1934. It arranged the sale of the entire Bulgarian tobacco harvest including old tobacco stocks accumulated during the depression with already deteriorating quality against a counter trade of trains, locomotives, railways, trams and other transportation equipment from German, Czechoslovak, Austrian and Hungarian companies (Ibid., 323). Germany had the biggest share of these deliveries equal to 631 million levs out

[32] See Protocol 170, of 30 May 1933 in *BNB Collection of Documents*, 2004.

of 910 million levs (Ibid., 323), which was achieved by offering the lowest price. The practices of selling at lower and buying at higher than world prices and targeting large quantities of perishable goods were characteristic German methods of trade not only in regard to Eastern Europe.

The considerable share of German trade and the increasing surplus of blocked reichsmarks were alarming to the BNB managing board, which recommended export diversification with other countries without provoking "repressive measures from the German side (BNB Collection of Documents, 2004. p 477)." There was a clear conflict of interests between the export sector demanding higher export quotas and the central bank accumulating blocked reichsmarks instead of free foreign exchange.[33] Nevertheless, in October 1939 the BNB signed a new agreement with Germany for a considerable increase of bilateral trade. It provided for the import of German agricultural machines in exchange for sunflower oil, silk threads and leather all under the clearing account. The import of raw materials including petrol and its derivatives for the needs of the Ministry of War were all under the free account.

3.4. Financing of Exporters and Inflationary Effects

The export surplus of Bulgaria meant that some exporters were still waiting to receive their revenues because there were not enough importers to deposit lev advances in the German clearing account. As of April 1937 the clearing account of the BNB was 10.1 million reichsmarks. The 1936 devaluation of the French and Swiss francs, the Dutch florin, the Czechoslovak krona and the Italian lira spread fears of eventual devaluation of the reichsmark among the trading community. Exporters of fruits and

[33] The term used for "quota" in the contemporary literature is "contingent".

vegetables, eggs and poultry frequently approached the central bank demanding that it buys out their accumulated claims. They argued that not only the exchange rate risk but also the non-durability of their products and the lack of alternative markets were serious threats.

Initially, the BNB's decree from 14 February 1936 stipulated that two thirds of the exports of these non-durable goods would be paid from the clearing account and one third as counter import from a German exporter as private compensation (Central Public Records Office, Sofia, F 285 K). In a letter to the Ministry of Finance the BNB reported this arrangement as economically suboptimal and suggested that buying a hundred percent of the Reichsmarks of the exporters in question would be a better solution. The BNB further proposed that the 2:1 ratio of clearing to compensation payments should be formally preserved for all export categories while at the same time the BNB should start a quiet payment of 100 percent of the clearing marks to fruit and vegetable exporters. These marks would be bought from the BNB by the government as the central bank could not be exposed to the exchange rate risk (Central Public Records Office, Sofia, F 285 K). The Council of Ministers voted the new directive published in the Official Journal N 160 of 2 July 1936.[34]

The financing of exporters, which started on 1 February 1937, and was planned for five consecutive years was organized as a BNB purchase of reichsmarks from the exporters at a fixed exchange rate of 32.50 levs per mark. The government afterwards bought up to 82.388 million levs worth of reichsmarks from the central bank at 33 levs per mark.

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[34] The Official Journal is a government-issued newspaper for the purpose of officially announcing new legislation.

The financing principle constitutes of new money issues backed only by the blocked Reichsmarks. Although the step was unilaterally taken by the BNB and the Bulgarian Ministry of Finance it was in line with the interest of the German government, which limited exports in its mobilization effort. By financing its exporters with new issues of levs the Bulgarian government was crediting German consumption. The purchase of RM was guaranteed to exporters only for two months and could not be renewed.

In 1938 the government issued a statement by which it assumed the entire political risk of the export of grape and other fruit abroad and guaranteed all payments to exporters in case those were prevented by adverse developments like mobilization and war (Ibid.). Clearing surplus rose from 1 800 m levs to 15 000 m levs between 1939 and 1942 (Avramov, 1999). On 2 April the BNB allowed local lending institutions to extend loans in levs against foreign currencies and receivables under clearing (Ibid.).

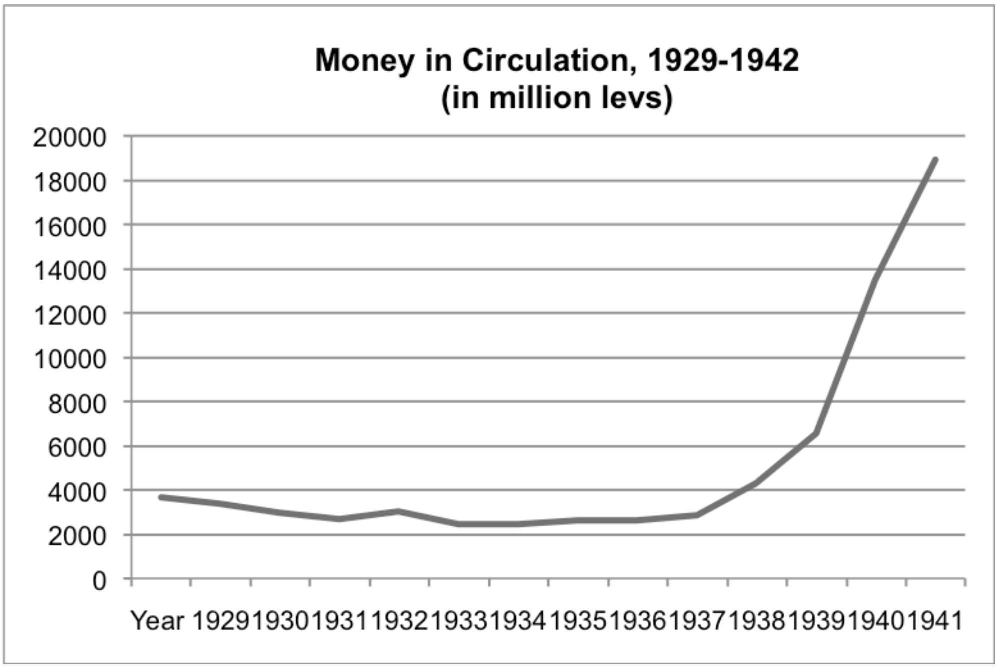
This policy was a reaction to a specific problem and not a result of ideological or political commitment to Germany. Nevertheless, by pursuing its national interest and defending the solvency of its economic actors the central bank became a channel of foreign authority allowing the exports to continue instead of finding an alternative or bearing the negative consequences of exiting the relationship with the Reich. The state reorganized itself as the central manager and coordinator of economic activity. The BNB complied strictly with German demands and changing trade rules and kept the value of the reichsmark in relation to the lev stable for ten years – the longest of all Southeast European countries. This exchange rate was only valid for trade transactions while officially the currency was fixed to the Swiss franc. This is another example that the Bulgarian choice was consciously made for integration with the

German economy. It was also legitimized domestically through an efficient corporatist organization of interest representation and paternalistic economic policy.

However, the Bulgarian institutions demanded that the German authorities honored the trade agreements. The Archives of the German Ministry of the economy (Reichswirtschaftministerium) show that the Bulgarian credit at the clearing account is over 60 million reichsmarks in 1940, which the report states is equal to each Bulgarian (6,5 million citizen at the time) to give Germany 10 reichsmarks. The report by Dr. Landwehr explains that Bulgaria is crediting its exports to Germany with new emissions of banknotes, which poses the danger of inflation. He also writes that Bulgaria is a very important supplier of foodstuff, has adjusted its economy to the German needs and expects German help in developing its agricultural economy. All Balkan states know that Bulgaria is very strongly connected 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" (Bundesarchiv R 43 II, 1303). The report urges the German Ministry of Foreign Affairs to increase the deliveries to Bulgaria in accordance with the signed contracts and to make deliveries to Bulgaria a priority. Various reports acknowledge that Bulgarian exports to Germany have been uninterrupted and regular but unless Germany honors the agreements they would be unable to continue (Ibid., as cited in Asenova, 2008).

The increased money supply caused a rise of the cost of living and wholesale prices (Figure 5 and Table 12). The BNB was evolving into a credit institution for the national economy and the government, which it had been originally envisaged as and what it officially became in the 1950s.

Figure 5. Money in circulation in Bulgaria in million levs.



Source: Mitchell, Brian. 2007. *International Historical Statistics Europe 1750-2005,* Palgrave McMillan.

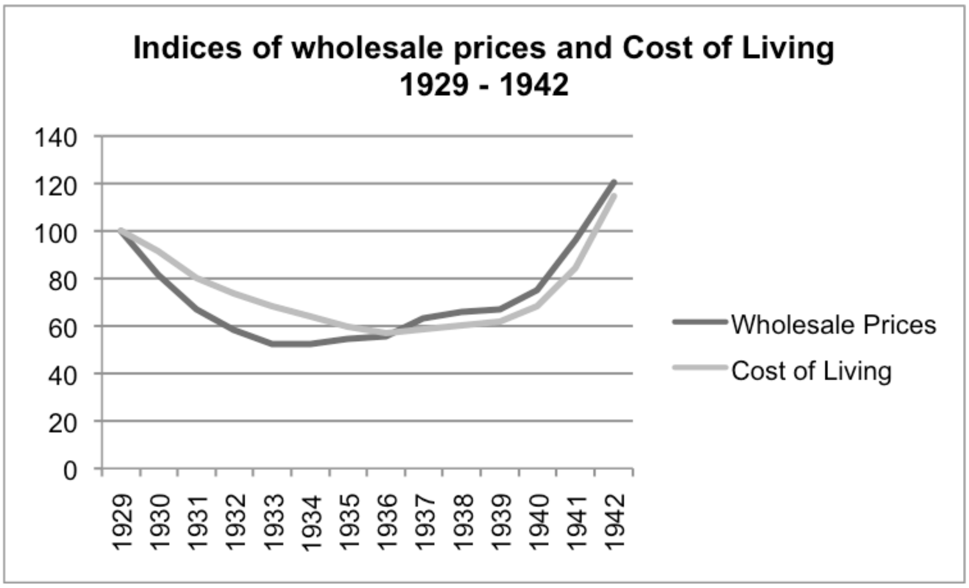
Table 12. Indices of wholesale prices and cost of living (the year 1929 = 100).

Year	Wholesale prices *(1929 = 100)*	Cost of living *(1929 = 100)*	
1929	100	100	
1930	81.2	91.5	
1931	66.8	79.9	
1932	58.3	73.4	
1933	52.4	68.2	
1934	53.4	63.7	
1935	54.4	59.5	
1936	55.4	57.0	
1937	62.8	58.1	
1938	65.5	60.1	
1939	66.7	61.6	100
1940	74.8	67.9	112
1941	95.7	84.2	135
1942	120.5	*114.7	178
1943	144.6		e 221

Source: League of Nations Statistical Yearbook 1942-44. pp. 194 and 199.
Note: * Index numbers for workers households. For the year 1943 "e" in the last column means that the value is an estimate.

Table 12 shows that between 1929 and 1936 we see a steady deflation – both the wholesale prices and the cost of living are falling. In 1936 both indices begin to rise with the rise in wholesale prices surpassing the rise in cost of living. The last column shows the dynamic of the cost of living index if the base of 100 percent was set at the 1939 value. It shows that between 1939 and 1943 the cost of living increased 120 percent. If the year 1939 were the basis with an index 100, the cost of living index in five years' time is estimated at 221.

Figure 6. Indices of wholesale prices and cost of living.



Source: League of Nations Statistical Yearbook 1942-44.

Bulgaria finally suspended the nominal gold standard in 1941 when it joined the Axis powers and signed an agreement with the Reichsbank to finance the German forces in Bulgaria. For that purpose the BNB issued two loans – one of 400 million levs and one of 500 million levs to cover the army's needs and another 1 270 million for the purchase of machines, vehicles and spare parts for them from Germany despite its surplus on the clearing account.

3.5. Wartime Economic Relations

The control over money and trade increased during Bulgaria's participation in WWII. In 1940 a special German-Bulgarian economic commission was established in order to organize the Bulgarian export to Germany in line with the growing demands of the German army. A year later a joint German-Bulgarian industrial commission began to operate in order to coordinate the long-term industrial cooperation and technological upgrading of the Bulgarian industrial sector (Nikova 1996:417). Trade with Germany in 1942 was already 72 percent of total value of trade and increased to 83 percent in 1943 (Lampe, 1986). Tobacco continued to be the main export item. Its quantity increased while its price declined. Pulp registered a huge increase to 11 percent of all exports, while fruit and vegetable exports declined. (Ibid.). Despite the importance of German demand for this increase of export, Germany's role in developing the pulping technology or modernization of agriculture was minimal (Lampe, 1986: 108). The state bureau for export of food, Hranoiznos, used the collected "foodstuffs for supplying the German army first for its 1941 attack on Yugoslavia and Greece and later for its occupation troops."(Lampe, 1986: 109) A new clearing and trade agreement was signed in 1940 stipulating that Bulgaria should "accept payment for Bulgarian exports in new notes emitted by the Bulgarian National Bank if German imports are not immediately forthcoming to balance the transaction" (Lampe, 1986: 113).

During the war Bulgaria had a continuous export surplus with Germany, which often failed to deliver the promised industrial and agricultural goods. The Bulgarian gains from trade were also affected by the reduction of import tariffs implemented under German pressure and the increase in prices of German goods above those initially negotiated. In an effort to avoid the trap of clearing trade producers diverted their goods to the domestic black market creating upward inflationary pressures (Lampe, 1986:115). In Lampe's account of the Bulgarian economy, the German-Bulgarian Industrial Commission of 1941-2 is seen as an institution aiming to prevent the development of local industry by controlling it through a single cartel (Ibid., 117). Some contemporaries saw this last agreement of 1940 as a way for Bulgaria to finance "someone else's war" through unfairly low prices of the produce (Lestov, 1940:341).

In 1945 the BNB governor Gunev and all the members of the governing council of the BNB were prosecuted and sentenced to death by the People's Court for involving Bulgaria in the WWII and supporting Nazi Germany both financially and in kind through the clearing accounts. The prosecution was based on evidence that during the war the BNB actively promoted an increase of exports to Germany by means of increased domestic money supply.

Table 13. Money in circulation and the increase of blocked reichsmarks in the clearing account, 1940 – 09/30/1944.

Year	Clearing balance *(in 1000s levs)*	Year on year Increase *(percentage)*	Money in circulation *(in 1000s levs)*	Year on year Increase *(percentage)*	Clearing as % of money in circulation
1940	+ 1 780 382		5 899 163		30.18
1941	+ 7 899 830	444	13 467 119	228	58.66
1942	+13 500 496	171	18 921 908	141	71.35
1943	+20 308 888	150	23 959 956	127	84.76
09/30/1944	+23 979 956		a. 40 732 005		58.87
			b. 14 787 940		
		118	a+b 55 519 945	232	43.19

Source: BNB Collection of Documents Vol. 4, p 985 (2004) and author's calculations; Note: a – banknotes in circulation; b - Government bonds used in domestic exchange the data is until 30/10/1944; a+b is the value of money in circulation which includes the banknotes and the government bonds used in domestic exchange.

Table 13 shows the continuous increase of the clearing assets in nominal terms and as a share of the monetary base in Bulgaria. Money in circulation grew at a rate similar to the growth rate of the clearing assets until 1943 but in 1944 due to the increased issue of government bonds used in domestic transactions the *de facto* money in circulation increased more than the clearing assets.

The government-issued bonds, based on the exporters' claims in Germany, were approved as a means of exchange for certain domestic transactions. Their volume reached almost 15 million levs and if added to the legal tender the total amount of currency in circulation reaches 55 519 945 levs. Effectively the blocked reichsmarks served as a base for increased liquidity and formed almost 59 percent of the money in circulation. When the money in circulation includes the not only the bills but also the bonds this shares drops to 43 percent.

The Bulgarian assets blocked in the Reichsbank clearing account reached almost 24 billion levs[35] in 1944. If the German assets held in Bulgaria are subtracted from the claims this amounts to a net claim of 15 986 million levs or almost 500 million reichsmarks. This claim was declared irretrievable after Germany's loss of the war. With the Paris peace treaty of 1947 all commercial credits to Germany made by the countries, which lost WWII were annulled.

[35] These claims are equal to 11.8% of Bulgaria's national income at current prices in 1944 or to 44.8% at constant prices of 1924. (Author's calculations based on GNI data in Rangelova, 2000).

Conclusion

As a reaction to the Great Depression and growing German pressure the Bulgarian national bank transformed the monetary regime in Bulgaria and its role in centralizing all international capital and trade flows. Its policy contributed to a marked economic recovery but tied Bulgaria to its main trading partner - Nazi Germany. This relationship was of a client – patron type, where the small state allowed itself to become dependent on the big one by actively adjusting its rules and institutions to its demands. This policy was seen as a promising strategy for recovery and Bulgaria's loyalty was acknowledged and rewarded in advance of its joining the Axis in 1941.

By establishing a monopoly over money and trade, the central bank did not solve the problem of foreign exchange shortage but reorganized the economy so that trade continued despite its absence. The solution was not derived from theory or from a readymade ideological framework but developed gradually through an everyday dealing with ad hoc problems. Short-term solutions in response to German demands resulted in a lasting government monopoly over monetary transactions, trade with Germany and other countries and the production processes.

Later in the CMEA system dependence was to a similar degree - about 60 percent of total trade on average. This economic dependence was not only facilitated by very similar institutions but the earlier experience as a German supplier of raw materials and agricultural products in exchange for industrial goods prepared the institutional setting for a smooth transition to a new international system where the previous structures continued to operate while the actors and the ideology changed.

Chapter 4: Effects of the Clearing Regime on Domestic Structures: State Corporatism in Bulgaria

The traditional narrative portrays the small states as devoid of choice whether or not to support the hegemonic regimes, they are often portrayed as simply absorbed into a sphere of influence and had to play by its rules. While this view is not completely unfounded, it is “a mechanistic view of how politics work” (Janos, 2001). The small state’s choices, abilities or needs to integrate with the hegemonic state matter for the emergence and continuation of the regime of cooperation. Small states are not always passive receivers of international rules; they can under certain circumstances upload institutions serving their interests and are always actors in the process of cooperation, which sustains the regime.

This chapter demonstrates that the shift of authority from the small state to a larger external polity coincided with a shift of authority from societal actors to the state. It presents in detail the institutional effects of economic crises in the 1930’s. The extension of state control over foreign trade and payments limited the economic freedom of private actors. However, state intervention had concrete beneficiaries among special interest groups, exporters associations and producers who received government financing and other forms of patronage. Thus, anti-crisis measures in the interwar period produced a change in the model of capitalism, a transition from free market capitalism and global capital mobility to administratively managed national economies in the framework of bilateral clearing regime. While accepting a certain dependence on a foreign trade partner governments still acted as agents of domestic economic interests and managers of the economic process.

The simultaneous external decrease and internal increase of state autonomy resulted in the emergence of a state corporatist model of capitalism as defined by Schmitter, 1979. The new state corporatist regime in Bulgaria was legitimate as long as it served domestic economic interests. The relations between special interest groups and the state are examined through the archives of the central bank; public statements and corporate correspondence between exporters associations and the government as well as the state export agency archives.

While transforming its system of interests representation into a state corporatist one the Bulgarian government did not imitate the totalitarian model of Germany. This case demonstrates that small states have greater autonomy than it is usually assumed, located primarily in their capacity to control and transform their domestic policies and institutions.

4.1. Bulgaria and Germany in Hierarchical Relations

The changes in the domestic organization of the economy were direct institutional responses to changing German rules of foreign trade but they did not lead to a totalitarian state like the Third Reich. Despite the national socialist rhetoric employed by many Bulgarian politicians at the time, societal groups and actors remained much freer from terror while voicing their demands and disagreements with the government. In Germany "terror was … used to control groups and organizations central to German society and economy" (Temin, 1991:582). According to Hayes "Hitler is supposed to have told Schacht, "The primary cause for the stability of our currency is the concentration camp" (Hayes, 1987) quoted in (Temin, 1991:582).

Not only were Bulgarian societal groups more free to disagree with state policies but also leading economic and political figures expressed criticism of the Nazi regime and warned of the threat it posed to national economic independence.[36] Boris Yanchulev declares, “We cannot import and imitate every successful economic institution from abroad – each nation state should shape the character and peculiarities of its economic institutions according to its own economic needs” (Todorova, 1996: 410). The policy of blind following of western models was criticized after the First World War left Bulgaria on the verge of a national catastrophe. From this turning point until 1944 a new course of policy based on the national traditions and specificity was followed as a developmental strategy as opposed to the adoption of foreign institutions and practices from the national independence until the (Daskalov, 2005).

Economic dependence on Germany was not simply a result of a pro-fascist or pro-German policy orientation (Georgieva, 1997). There was a big debate at the Bulgarian Economic Society[37] on the role of Bulgaria in the postwar economic order promoted by Germany. Alexander Tsankov argued in favor of including Bulgaria in the post-war economic plan as it was discussed in 1939, which created a huge controversy at the Society meeting. Bobchev and Atanasov criticized his views saying that the war should not be the decisive factor for the foundation of the new economic order in Europe. The topic was not discussed for a year and renewed in 1940 and calls for economic nationalism serving the interests of the state were

[36] An editorial publication in the journal of the Trade and Industrial Chamber in Varna, *Economic reports (Икономически известия)*, 1938, vol.2-3 pp.1-19.

[37] Bulgarian Economic Society functioned until 1944 and included distinguished economic experts, academics and politicians – half of the prime minister nominations, 37 out of 43 ministers and almost all political economy professors in Bulgaria were members of the Society. Its publications are a major source in studying the dominant views of the Bulgarian economic policy elite of the time (Todorova, 1996: 406).

directed to the government. In 1943 the German postwar plans for organizing the European economic space and especially its part on "food freedom" (or food security – *Nahrungsfreiheit*) were criticized in a debate with the German economic representative then visiting Sofia – Franz Algriem. The Bulgarian economist Nikolov published an open critique of the thesis of Herbert Backe[38], which assigned an agricultural specialization to the entire region of Eastern Europe (Todorova, 1997:413). Framed in terms of economic nationalism, policy debates invariably separated the national interests, which this economic cooperation served from the political and military aspirations of the Nazi regime. The Society discussed the leading role of the state for the modernization and development of the economy and saw the Bulgarian-German economic relations as an opportunity to advance these processes. Their preference for economic nationalism was not for autarky but for protectionism.

The authority and reputation of the German economy and culture was traditionally high in Southeastern Europe and the Reich did not hesitate to use the reputation of private firms and the cultural attraction of Germany to increase its credibility and extend its political influence in the region (Gross, 2010). The Bulgarian state on the contrary always insisted on the separation of economic and political motivations for cooperation. Bulgarian diplomats often explained that the propaganda in the local press was "pro-German" not "pro-Hitlerist".[39] Similarly, the institutional changes in the foreign trade organization were not a result of imitating the German

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[38] German minister of food (1942) and minister of agriculture (1944), author of the Hunger plan for the starvation of 4.2 million people in the Soviet Union (Snyder, 2012).

[39] Bulgarian ambassador to Moscow declares this position in front of the Soviet minister of foreign relations in 1938 (CPRO 176K 1/2562:3).

model of domestic political organization but a national reaction to specific German demands in the foreign trade sector in the pursuit of concrete economic gains.

However, political interests became more salient in the context of the war when Germany increased its pressure on Bulgaria to join the Axis powers at the same time negotiating contested territories with its neighbors. According to the German press Bulgaria was part of the German great living space and it was in Germany's best interest not to allow strong Russian influence in Bulgaria. With the assistance of the German diplomacy on 7 September 1940 the territory of Southern Dobrudja was transferred from Romania to Bulgaria[40]. At the same time Germany at least rhetorically treated Bulgaria as an equal partner. During negotiations at the Bulgarian embassy in Berlin in December 1940 German diplomats advised that Bulgaria should not expect any certain promises and that in politics they have to compete, and not rely on friendship (CPRO, Sofia, F 316/1/189/19).

Bulgaria adopted a model of integrationist foreign economic policy as a developmental strategy, which encouraged integration with Germany. Agriculture was the dominant sector of the economy; it employed most of the population, which was enjoying a comparatively well developed social welfare system and high levels of literacy and was well represented in political decision-making. Industry had a secondary role and was not a priority of the export policy. For a number of reasons Germany was seen as the leading economy and by integrating with its economy Bulgarian agricultural production would receive valuable capital goods and know-how to modernize its process and organization. Therefore closer integration and dependence on Germany was encouraged by state policies rather than resisted to.

[40] To honor German involvement in this diplomatic victory Bulgaria awarded Herman Goerging and Joachim von Ribbentrop the St. Alexander medal and necklace.

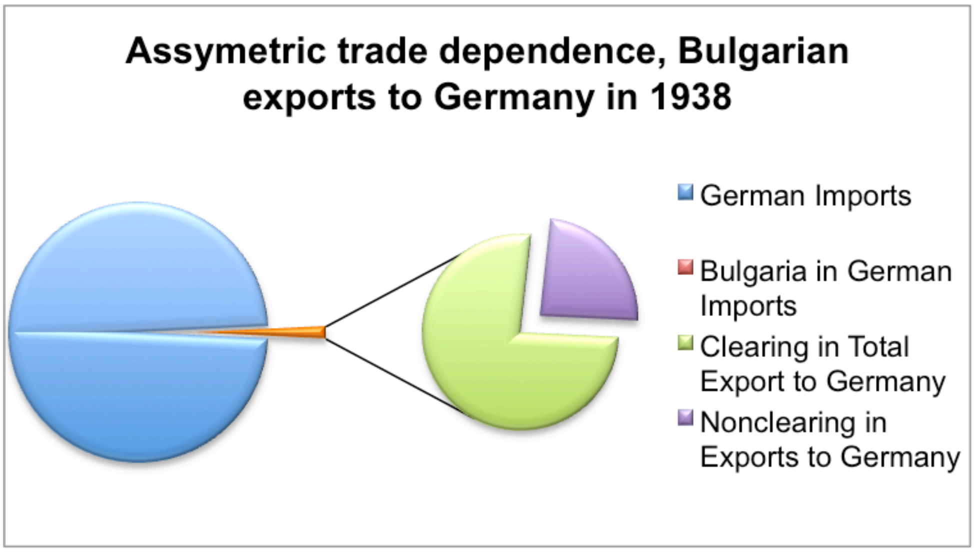
On 24 June 1932 the German-Bulgarian bilateral clearing and trade agreement was signed. According to this agreement the Bulgarian National Bank opened an account in levs in the name of the Reichsbank and the Reichsbank respectively opened a reichsmark account of the Bulgarian National Bank in Berlin; German importers paid for Bulgarian exports by crediting the Bulgarian blocked reichsmark account at the Reichsbank; German exporters to Bulgaria were compensated from the same account. The agreement also states that payments were to be cleared in reichsmarks between German importers and exporters. Bulgarian exporters to Germany respectively were paid by Bulgarian importers from Germany. What crossed national borders were goods and notifications between the central banks but no foreign exchange. The introduction of exchange control and bilateral clearing in 1932 did not solve the problem of foreign exchange deficiency but prevented its aggravation and facilitated international trade in the absence of international money.

The 1932 agreement provided that on the last day of each month the corresponding clearing accounts, if not in balance, should be compensated according to the average exchange rate of the Reichsbank in Berlin (Central Public Records Office, Sofia 285K/5/80). However, as the balance was predominantly positive for Bulgaria the German side ignored this clause allowing the amount of blocked reichmarks on the Bulgarian account to grow. These assets were legally the property of Bulgaria but their use was conditional on German discretion. The higher the export surplus of Bulgaria, the more leverage the Reichsbank had on Bulgaria's supplies of industrial goods and raw materials. The greater the amount of blocked assets at the Reichsbank, the higher the costs of exiting the relationship. This created a disincentive to orient trade to a different partner.

The importance of Germany as a trading partner was growing both in terms of total trade and clearing trade as shown in Table 1. Bulgaria exported agricultural goods and raw materials in exchange for German industrial goods and later for military equipment.

Imports from Bulgaria accounted for only 1.5 percent of total German imports in 1938. The same trade volume consists of 59 percent of total Bulgarian exports (Hirschman, 1945). Hirschman's discussion of national power and the structure of foreign trade is even more convincing if we add the structure of foreign trade financing to the asymmetries in trade volumes as presented in the following Figure 7.

Figure 7. Asymmetric trade dependence, Bulgarian exports to Germany in 1938

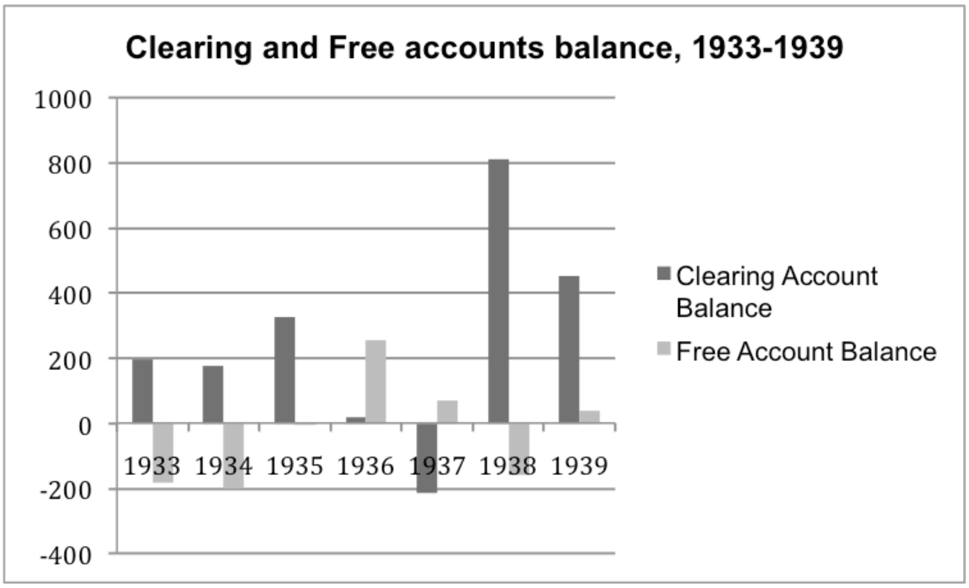


Source: Hirschman, 1945.

Figure 7 shows that Bulgaria had a share of only 1.5 percent of total German imports which was divided into 76 percent under the clearing account and 24 percent under the free account. Additionally figure 7 shows that clearing did not completely replace free trade, which would seem to indicate that German influence was limited to the extent of the blocked reichsmarks in the clearing account of Bulgaria. However, the free currency, which was acquired through trade with Germany, was not really free but also controlled by the Reichsbank. Its use was assigned to the import of hard currency goods from Germany such as oil and to payments of freight fees in third countries for the Bulgarian-German trade. Thus even though payments were made in convertible currency its use was controlled by the German government.

At the same time the blocked assets also increased and with them the indirect German influence on the Bulgarian economy.

Figure 8. The clearing and the free account of the BNB in million levs.



Source: BNB Annual report for 1938, BNB Collection of Documents Vol. 4 p 260. and Central State Archive 285K/5/250.

The system of financing through blocked accounts unlike a system of free capital movements is rigged in favor of the country, which holds relatively bigger share of blocked assets, that is the country with the negative trade balance. Another source of free exchange was Bulgarian exports to the free exchange market of corn, barley, oat, sunflower seed and fodder. These products however were of relatively low value added compared to the clearing exports and bad harvest often affected adversely the balance of convertible currency. Tobacco, fruits and vegetables, meat and eggs were mainly exported to the clearing market.

Cooperation under bilateral clearing results in convergence of interests between the partner countries through the effects of both monetary and trade dependence (Kirshner, 1997). Thus from the German point of view cooperation and continuous supply could be secured at a lower cost as opposed to coercion. From the Bulgarian point of view the convergence of economic interests legitimized the subordination to Germany. At the same time the Bulgarian government held the public position that it does not support Nazi ideology and is doing business with Germany but politics with France (Markov, 1984).[41] The Bulgarian government in the 1930's did not only "fail to make efforts to diversify [its] alliances and trading partners" and thus signaling its acceptance of foreign authority over economic policy (Lake, 2009). It also completely reorganized its international trade sector to achieve a more efficient cooperation with Germany.

While giving up certain authority over foreign trade the state retained full discretion over how to organize its domestic monetary policy and how to regulate the relations between exporters and importers in the country. The degree of dependence on bilateral clearing trade is a direct result of government policy. The bureaucratic control of trade was concentrated with a special Commission for Imports at the BNB which kept lists of companies, the amount of clearing levs they were allowed and the exact items they could purchase with it. Very often importers declared higher prices for their imports in order to secure more clearing levs for importing bigger amounts. In order to close this loophole the national bank issued an ordinance in 1934 by

[41] It could not do business with France significantly because due to its colonial position France had very little economic need for Bulgarian exports and Bulgaria had very limited foreign currency available to make purchases in France.

which it fixed the clearing lev allowances based on the quantity of goods rather than price value[42]. The main export items, tobacco, eggs and wheat, were directed towards Germany through the Commission's licenses. The BNB's discretion over what to import with the free account reichsmarks was only limited by the German government's regulation of exports. German raw materials such as cotton, wool and leather were imported for the Bulgarian textile industry. According to some reports by 1934 the clearing trade was already 88 percent of all imports and 83 percent of all exports (Kemilev, 1940). For the Bulgarian economists of the time this was a remarkable state control of the international economic relations in the absence of war or an active militarization program.

The policy of the central bank toward the blocked accounts at the Reichsbank and the promotion of trade under clearing were domestic political decisions. The emphasis is on cooperation and not coercion and the power of Germany is based on its authority as a foreign trade partner not on its use of military threat or political appeal.

The new system that emerged as a result was not a national socialist one but a new for Bulgaria system of capitalism that can be best, characterized as a state corporatist one. The Bulgarian government was in a position to balance the interests of exporters and importers not only when they clashed against each other but also when they clashed with the interests of the German government. This respectively meant coordinating the interests of the agricultural and industrial sectors, the former being a primary exporter and the latter taking the majority of imports.

[42] Ibid, Protocol 466.

4.2. State Corporatism in Bulgaria 1932-1939

Coordination of the economy in the 1930's took the form of a state corporatist structure and comes close to fulfilling Philippe Schmitter's definition of corporatism and more specifically of state corporatism, namely:

> Corporatism can be defined as a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, non-competitive, hierarchically ordered and functionally differentiated categories, recognized and licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports. (Schmitter, 1974, p.93-4)

and:

> State corporatism tends to be associated with political systems in which territorial subunits are tightly subordinated to central bureaucratic power; elections are non-existent or plebiscitary, party systems are dominated or monopolized by a weak single party; executive authorities are ideologically exclusive and more narrowly recruited and are such that political subcultures based on class, ethnicity, language or regionalism are repressed. … state corporatism seems to be a defining element of, if not structural necessity for, the anti liberal, delayed capitalist authoritarian neomercantilist state. (Ibid. p. 105)

My analysis focuses exclusively on the "system of interest representation" for the foreign trade sector and does not deal with the changes in the nature of political parties, elections and the position of subgroups in relation to the political process. This is justified by Bulgaria's relative high ethnic, linguistic and religious homogeneity and the lack of well defined classes due to over eighty percent rural population and a very small and underdeveloped industrial sector, accounting for only five percent of Bulgaria's exports. For the period between 1934 and 1944 Bulgaria fulfills the criteria of "anti liberal, delayed capitalist authoritarian neomercantilist state" (Schmitter, 1974:105). It is also important to mention that various social, economic and political organizations functioned in a quasi-corporatist manner before the period under review but only after 1934 the central government became the main organizer of all aspects of economic activity.

4.2.1. The organization of foreign trade in Bulgaria

State corporatism in Bulgaria is specific to the 1930's, neither before nor after this period has corporatism been so distinctly present in Bulgaria. After the independence from the Ottoman Empire (1878) mostly foreign merchants were in charge of trade organization in the new Bulgarian kingdom. After the Great War when more and more Bulgarian merchants took on international trade activities and promoted the first policies for improving the organization of trade, quality controls, payment methods, import and export agreements and the customs policies of the state. Merchants of different specialties were members of the Bulgarian Union of Traders, established in 1924, which operated through local branches in each town as the only foreign trade association until 1934 (CPRO, Sofia, F 1580 K/1/16). In 1934 all political parties and social organizations were banned by law. In 1935 all functioning trade organizations including the Bulgarian Union of Traders were liquidated according to Ordinance N. 38 of the Law for the Trade Organizations. The same law established the singular organization of traders with the name General Union of Bulgarian Traders. This was the first time traders were associated into sectors first and then into exporters and importers. All exporters' associations were members of the private Union of Bulgarian Exporters[43] (UBE) and the importers of the Import Central[44]. Membership in the Union became compulsory under the Law for Organization and Control of the Export.

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[43] The Union of Bulgarian Exporters included the associations of exporters of eggs and poultry, tobacco and tobacco products, grapes, fruits and vegetables (fresh and processed), raw and semi-

All matters regarding a certain product were deliberated within the sector-based association, while general questions were discussed at the Central Office of the Union. Such questions were production plans, price policy, securing new markets, transportation, the government's economic policy as a whole, keeping the export sector in Bulgarian hands, access to export credit, freedom of private initiative to find the best market conditions for Bulgarian exports. As stated by its director, Hristo Yotsov:[45]

> In accordance with the law and the economic common sense the Union of Bulgarian Exporters needs to maintain close relations with the government institutions who design and implement all export regulation (CPRO, Sofia 1580/1/16).

The main state institutions, regulating export were first and foremost the Bulgarian National Bank (BNB), the Ministry of Trade and Industry with its subsidiary the Export Institute (EI), established in 1935 by the Law for Organizing Trade. Other directly involved institutions were the railways, the post office, customs, public storage facilities, credit institutions etc. In addition the Bulgarian Foreign Service was actively engaged in export promotion. The main organ for deliberation between the exporters, the Export Institute and all other institutions was the General Assembly at the EI.

All exports were organized following a strict hierarchical structure. Various documents from 1935 to 1939 give a good overview of the organizational structure and its principles. The Ordinance N. 435 by trade Minister Kozhuharov of 14 June

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processed hides, grain, oil-yielding seeds, beans, wine and other alcoholic drinks, meat and lard, milk products, rose oil and other ether oils, herbs, animal wastes, coal and ores, crafts and home-industrial products (Central Public Records Office, Sofia, 1580 K/1/22).

[44] The Import Centrals were shareholding structures, which imported raw materials for the industry from various countries. The imports were approved directly by the Bulgarian National Bank.

[45] Hristo Yotsov was born in 1894 in the family of a wealthy merchant in Vratza, Bulgaria. His family firm «Yotsov Brothers» was the biggest exporter of eggs from Bulgaria; President of the Bulgarian Union of traders in the 1920's; president of the Union of Bulgarian exporters 1935-1944; chairman of the Managing Board of the Import central Bulgarian Trade in 1947 and chairman of the Bulgaro-Yugoslav Chamber of Commerce 1947. Yotsov died in Sofia in 1983. In 1929 his younger sister Liuba won the first Miss Bulgaria beauty contest.

1939 specifies the responsibilities of the Export Institute. Its president is responsible for conducting research on the domestic and foreign markets and for promoting the export of Bulgarian goods. The EI in cooperation with the administrations for the forests, waters, scientific and experimental agricultural institutes and the central association of the producers conducts constant quality control. The EI president also supervised sorting and packing the export products, monitors the size of sown land, plant diseases and standardization of the exported produce and cultures.

Directly subordinate to the president were the inspectors for animal and plant products. “Their primary duty was to maintain close contact with the associations of exporters of animal and plant products”. Their objective was defined as “all-encompassing assistance of the export; organizing the exporters in mandatory associations and monitoring their activity in and outside the country. Monitoring the activities of traders non-members to the associations; controls for the allotted to Bulgaria quantities of export goods; planning and directing the export of Bulgarian products to as many as possible foreign markets; organizing the internal market in accordance with the exports; monitoring the relations between producers and exporters; monitoring the rates of consumption in order to prevent it being sacrificed to increasing export; researching the possibilities for increasing the competitiveness of the exported Bulgarian items by pushing the prices down but not below their cost of production” (CPRO, Sofia, F 259 K/2/77). The chief inspector for transport maintained contacts with the Bulgarian State Railways, the ports, the posts, telegraphs and telephone stations and the Ministry of Infrastructure. The inspectors for canning and refrigeration had similar functions, contact with the producers’ associations managing and control of the production; assisting the export of nondurable goods; conducting research on new methods of storing and processing fruits and vegetables (CPRO, Sofia, F 259 K/2/77).

The tobacco export sector, which was a monopoly structure, had its own director at the EI, who was responsible for relations with the tobacco exporters' associations, the Ministry of Agriculture, the Ministry of Finance, Bulgarian Agricultural and Cooperative Bank and the Union of Tobacco Cooperatives (producers). The director also had to organize the exporters in a compulsory association and supervise their activity, to monitor the domestic market and Bulgarian tobacco's competitiveness abroad; to control the quality and quantity of produced tobacco, assisted by the regional inspectors. (Ibid.)

Regional inspectors monitored the volume and exercised quality control for the export products, supervised packaging the durability and size of carts at the export stations or ports before the merchandize was loaded and shipped. They informed the exporters about the markets' expectations with regard to quality, sorting and packing. They conducted qualification courses and presentations on the administrative requirements of the Export Institute; investigated for ways of improving transportation and logistics, and ensured the "correct" price setting in contracts between producers and exporters. They patrolled their regions five times a month and reported to the EI all incoming and outgoing correspondence as well as the quality certificates issued by them. As of 29 April 1939 they could not leave their designated region without the EI's allowance according to ordinance N. 381 by the Minister of Foreign Trade Kozhuharov (Ibid).

All these activities were kept confidential following the order of the EI president, Georgi Kanazirski[46] on 15 Sept 1938. It was forbidden to all bureaucrats and administrative personnel to give away any information regarding the EI's functions to external persons including government officials; they took an oath to keep this information confidential. (CPRO, Sofia, F 259 K/2/77) The EI's president had to approve any publications on the national export policy written by bureaucrats' before they went to print; only he was authorized to make announcements to the press and in his absence the deputy president could make announcements after the Minister of foreign trade granted approval. Even the starting date of the grapes harvest was not announced before the approval of the president of the EI. The Export Institute was in other words the "singular, compulsory non-competitive, hierarchically ordered categor[y] … created by the state" (Schmitter, 1970:93) for the purpose of foreign trade management.

Similarly to exports, the organization, management and control of all imports was the monopoly undertaking of the International Trade Directorate. The special commission at the BNB for the import of machines was also in charge of military deliveries from Germany after 1935. The Bulgarian state had undoubtedly more leverage on its imports than on its exports *vis-à-vis* the domestic economic groups but much less so *vis-à-vis* the German authorities.

According to Ordinance-Law for the Organization of Import of Goods from Abroad (1939) in order to be allowed to import, a registered enterprise needed a special license from the Directorate, had to have a minimum capital of 250 000 levs, no record of fraud or intentional bankruptcies. A certificate from the regional chamber

[46] Born 1884 in Bourgas, mayor of Bourgas 1925 to 1931; member of the National Assembly, 1931-1936; director of Department of Grain Export 1936 and of the Export Institute from 1938, dies in 1939 in Sofia.

of commerce was required testifying that its management was sufficiently competent and experienced in the sphere of import trade. The license had one year validity and covered the import of the following items: textile and textile raw materials, metal and machines, chemicals, drugs and cosmetics, food, household goods, petrol and lubricants, leather and leather products, electrical appliances, apparatuses, instruments and motor vehicles. Each license to import issued was entered into the Register of Importers at the Directorate, which kept a file of its activities. A license was refused if the company was proved to have damaged the good name of the Bulgarian export-trader abroad or violated the law. The ministry had the right to establish, reorganize and disband the Import Centrals and other related associations. The Directorate prioritized the goods for import according to their importance and controlled the maximum import prices and quality standards.

Under a clearing system interests of exporters and importers and their access to the market were balanced by the state through the established by it unions of interest representation and government agencies of control. Because this regime is asymmetrically dependent on foreign demand the exporters are at a higher hierarchical level than producers for the local market. However, local consumption was not sacrificed for increased exports.

At the international level the state had to balance German demand with the Bulgarian import and export needs. For information on German demand and opportunities to export the government relied on the commercial attachés at the Bulgarian embassies. Those were the key intelligence agents in the system of trade organization. Working for the same general objective, increasing exports and acquiring the best possible prices for them, they had the task to investigate the foreign markets and look for opportunities to place Bulgarian products there. They were to report on issues of demand, prices, the market's capacity, consumption preferences and tastes, competitors from other countries, administrative organization of the market in the country and the allowed import quantities from Bulgaria under existing bilateral agreements. They also had to work by diplomatic means for the reduction of red tape, acquiring quick access to the market and to signal timely about any possible threats. They had to provide quality control of imported Bulgarian goods; to monitor and support all Bulgarian (organized and individual) exporters and to maintain good relations with local trade authorities as well as to promote the "invisible export" - tourism of foreign citizens in Bulgaria.

The director of the EI, identified commercial propaganda as the most powerful marketing tool and in his letter to the commercial representatives from 1 May 1936 encouraged the use of friendly contacts abroad - journalists, artists, sportsmen and other public figures to promote the Bulgarian brand (CPRO, Sofia, F 259 K/2/77). Because the Bulgarian goods were new and unrecognized on the European markets, their placement required special efforts. All correspondence between the commercial attaché and interested Bulgarian exporters was copied to the EI and otherwise kept confidential. All private commercial activities of the Bulgarian officials abroad or through them on behalf of third parties were prohibited so that conflicts of interest would be avoided. Finally, the president emphasized that even though the EI is a state institution the commercial advisers should keep in mind that "trade tolerates no bureaucratism". The foreign commercial service should be extremely "efficient, flexible and accurate" in order to fulfill the great expectations of the state and the national economy", Kanazirski's letter concludes (CPRO, Sofia, F 259 K/2/77).

The officially set goals - exporting as much as possible to as many as possible foreign markets, was no doubt in the interest of domestic firms as well. Each firm's quantity and timing of export followed a pre-approved schedule. For example grape exporters to England[47] were ordered according to the exported volume in the previous year, priority was assigned from the biggest to the smallest volume. This order was announced in advance for every day of the week each week. Giving up the export allowance to another company as well as re-exporting from other countries was not allowed. Grapes were exportable on the free market against convertible currency therefore the state was especially careful not to miss an opportunity for export. If a company was unable to deliver all the allowed quantity it had to inform the EI or pay a fine. As ordered by minister of trade Vylev on 17 November 1936 when exporting grapes to Germany under clearing, deals were signed with the clause "valid only after the approval of the EI". The EI set the minimum export prices for these goods, checked and registered the invoices and only after that the BNB issued declaration N11 for export. The same rules applied to other exports to the free exchange market, such as strawberries.

Due to the increasing assets in the blocked account in Germany an amendment of the Trade in Foreign Exchange Law was adopted by the Managing Board of the BNB and approved by the Ministry of Finance 24 October 1939 ruling that all exporters request the permission of the BNB by declaring the kind, quantity and value of their export goods and specifying the agreed method of payment with the importer. Export permission was granted for a period set by the bank by issue of declaration N11 a copy of which was a necessary document for the customs office. Prior to the amendment declaration N11 was required only for certain products

[47] Only allowed for the best quality grapes. In its efforts to promote Bulgaria as a good trademark, the Ministry changed the name of a sort grapes from the Turkish name ''Afuz", still commonly used today, to "Bolgar" (CPRO, Sofia, F 259 K/2/77:279). In September 1938 the quality of the exported Bolgar is minimum 14 percent sugar and weight of 350 grams per 100 grapes (CPRO, Sofia, F 259 K/2/77:486).

(CPRO 1580K/1/29). Export controls were detailed and meticulously applied. A ministerial ordinance was issued to set the size of the barrels in which plum pulp was exported and the kind of wood they were made of. The minister of foreign trade personally specified the quality of wooden crates for export of peppers, the kind of aluminum used for canning tomato purée and even the size of the letters on the tomato quality labels (Caps lock, 2 cm high), in the language and measurement units of the country they were exported to (CPRO, Sofia, F 259 K/2/77:251).

4.2.2. The interests of exporters

The exporters saw this institutional arrangement as beneficial and legitimate in view of the circumstances, nevertheless they often voiced demands and criticism. The negotiation between the exporters, the Export Institute and all related state institutions took place in the framework of the General Assembly at the EI. In his speech on the occasion of the Day of the trader, Hristo Yotsov, director of the Union of Bulgarian Exporters, stated that negotiating among all interested parties was the only way to achieve a coordinated and efficient export policy. He advocated that a representative of the Union of Exporters be included in all lower level commissions at the Chambers of commerce, BNB, the railways, ministry of trade and industry etc. when concrete problems of the sector are being discussed. He explained that currently (1937) the interested associations were only asked to give an opinion, which was often ignored even when well argued and of national interest.

His comment on the increased state intervention in the economy is that it would be acceptable if the state provided guidance in line with the desirable political goals of the present moment but not when it assumes the right to manage private property.

State intervention is only legitimate if the administration has the needed capacity and qualification but not when it experiments with half-thought regulations and wastes public and private resources alike. He calls for greater responsibility on the part of the bureaucracy, which he criticizes for creating barriers to export. At the same time Yotsov advocates for a competent state intervention in the economy, which he understands as "steering" the economy as a whole in the right direction. He approves of the monopoly of the BNB over all monetary and foreign trade agreements. To end his patriotism-infused speech he states that the current century is an economic century; wars are fought for access to markets and a "firm statecraft is vital for success" (CPRO, Sofia 1580K/1/16).

In various articles, speeches and reports Yotsov presented the main achievements and challenges for the export sector. In 1935 he congratulated the union's members for the record export of grapes, which in his view was due above all to the "character of the Bulgarian export-trader, who demonstrated courage, creativity, flexibility and took the risk. This is a victory, a heroic act," he stated, "which speaks of the potential of the country amidst harsh competition from other more powerful and rich countries". He gives credit also to the Bulgarian producers and finally to the Bulgarian institutions, Ministry of Foreign Trade, the EI, the BNB, Bulgarian State Railways, which have provided full support and patronage. He relays an optimistic view that continuous hard work would yield such rewards the following year as well (CPRO, Sofia 1580K/1/21). For the year 1940-41 he reports that the presently existing organization of trade supports the interests of the exporters who are now providing military deliveries and have an optimistic outlook for building a "powerful economic Bulgaria" (CPRO, Sofia 1580K/1/22).

By 1937 the Export Institute enjoyed good reputation among the exporters; its director Kalendjiev being a former chairman of the Union of Bulgarian Exporters, shared the principals of dialogue with the traders. At the beginning of the institute's activity (1935) they demanded lower export duties; establishing veterinary conventions for the export of animals and meat, improved refrigeration[48], they criticized the chaotic industrial protection measures, the lack of a coordinated general economic policy and the exchange rate policy, which artificially suppressed the prices of local goods through a undervalued exchange rate of the lev. They were openly against the state support for the tobacco and rose oil monopolies, which had in their view access to better export credit conditions granted by the Bulgarian Agricultural and Cooperative Bank (CPRO 1580/1/14). Other lasting concerns remained the cost of transportation set by the state railways and the foreign currency policy of the BNB.

According to the exporters compensation deals and foreign currency premiums[49] were the main methods of increasing the prices of exports but the unstable premiums and unclear exchange rate regulations made it difficult for the exporters to calculate their export revenues. Their demands were for clear rules so that they know rather than speculate about the financial results. They also asked for more private compensation deals not restricted by the clearing agreements. Examples of compensation deals are the canning factories exporting tomato purée in exchange for metal caps, tin, glass jars and sealing machines. The payment was

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[48] At the time Bulgarian Railways did not have enough refrigerating wagons to satisfy the needs of nondurable goods exports and such wagons had to be rented from foreign companies for clearing or convertible currency.

[49] At the domestic market for foreign currency, administered by the BNB, foreign currency premium was the difference between the nominal exchange rate of foreign currency and the exchange rate at which the BNB *de facto* purchased foreign exchange from exporters. This premium was always in favor of exporters thus undervaluing the lev against hard currency.

settled through exchange of letters of credit between the BNB and the Reichsbank within the clearing agreement (CPRO, Sofia 512/1 /19).

In view of the importance of commercial contacts the exporters also insisted that their business travel abroad should not be limited by denying them foreign exchange. The exporters of grapes while accepting the dominance of the German market demanded that all bureaucratic barriers with respect to Germany be abolished. One of the main such barriers was the increasing volume of blocked Bulgarian assets at the Reichsbank. Fears about a future devaluation of the reichsmark and the uncertainty about the changing German foreign trade rules were expressed to the BNB with the demand for increased imports from Germany and balanced bilateral trade.

In 1937 exporters of fruits and vegetables asked to be paid for immediately as had been the case in the previous year when the German market was more open. They were well informed of their competitors' activities in Hungary and Yugoslavia who were granted special preferential treatment in certain export items and respectively demand that the Bulgaria government negotiates the same treatment for the Bulgarian much smaller export of the same goods[50]. The Bank's response to these demands was nothing short of the desired paternalistic steering of the export sector demanded by its representative.

After the beginning of the war deliveries from Germany became infrequent and expensive. A secret letter from the Bulgarian Agricultural and Cooperative Bank to the Ministry of Foreign Affairs and Religion detailing the difficulties in importing oil

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[50] They quote specifically lard and prunes, which were the main agricultural export items from Yugoslavia. The German strategy was to purchase big amounts of the main products in each country even if it did not need them in order to gain a leading position as a buyer and then at a later point to import what was more valuable, in the case of Yugoslavia copper and zinc. (Grenzebach, 1988)

from the monopoly German enterprise Deutsche Fanto-Mineraloel-Industrie Gesellschaft which re-exported Romanian oil to Bulgaria for a high commission.

The state reorganized itself as the central manager and coordinator of economic activity, subordinating the domestic outcomes of foreign trade to its preference for German authority, complying strictly with German demands and changing trade rules and keeping the value of the reichsmark in relation to the lev stable for ten years. The fixed exchange rate was only valid for trade transactions while officially the currency was fixed to the Swiss franc. This is yet another example that the Bulgarian choice was consciously made for integration with the German economy. It was also legitimized domestically through an efficient corporatist organization of interest representation and interventionist economic policy.

Despite the state monopoly over foreign trade, the state corporatist regime of the 1930's is qualitatively different from the monopoly of the socialist state established after 1947. Corporatism implies in the discussed case demonstrated in practice, "some separation of arenas and a state that has some autonomy" Bunce, 1985:5). In addition the separation of the political economic and social arenas enabled the private sector to define the national interest and shape the agenda of international economic negotiations. In the Stalinist political economy the "political economic and social arenas, roles and resources were interdependent and fused" (Ibid.). Bunce, 1985 uses the term fusion "to emphasize how uniquely merged, concentrated and interdependent resources are in a Stalinist political economy"… and "fusion should not be confused with corporatism".

Conclusion

Economic integration between Germany and Bulgaria promoted more centralized domestic institutions of a hierarchical state corporatist type. It was achieved through the trade and payments regime where the small state's monopoly over its economy was a necessary condition for economic cooperation with the core state. In this process of giving up authority to the dominant state and extending authority over more and more spheres of domestic economic activity the small state acted as a promoter of domestic interests.

The state not only took a leading role in the foreign economic activities of private organizations, but also created and organized the institutions of interests' representation and acted as a defender of the national economic interest as expressed by these organizations. Thus its control over the economy was seen as legitimate in view of the circumstances and as necessary in the context of the international conditions.

The relationship between external and internal authority was determined by the international trade regime promoted by the core state and the degree to which the small state complied with it. However, the domestic institutions of the small state are still its own best resource and provide the possibility for various domestic arrangements to resist or utilize the position of international subordination. Bulgaria's giving up external authority to Germany did not diminish its domestic capacity for organizing a system of interests' representation and acting as a domestic agent in international negotiations. This was achieved without the state being a totalitarian one. Actually private actors and associations in Bulgaria enjoyed greater freedom than in the core state, Germany. The clearing way of payment was not Bulgaria's most preferred one and hence Germany was not its most preferred trading partner.

Exporters would much rather sell to a hard currency-paying trade partner such as Great Britain. Even though Germany was not the most preferred partner, it was the only one available and certainly in a position to set the rules of the international trade regime. However, this does not mean that Bulgaria was coerced or exploited. Through cooperation and adjusting its domestic institutions rather than imitating a foreign model it made the most of its situation and found an efficient way out of the Great Depression. This demonstrates that the small states, however underdeveloped and vulnerable, have more choices than it is usually assumed, located primarily in their domestic policies and institutions. The varieties of internal adjustment however are not fully prescribed by international arrangements but offer an area of potentially constant institutional change.

The German trade regime might be seen as providing the necessary institutions for a quick reorientation toward the socialist system of international political economy. It introduced state monopoly over international trade, which was the first state monopoly to exist in socialist Bulgaria. However, the two periods had different *modus operandi*, different organizational principle and legitimizing logic. Communication between government, state administration and society was conducted in markedly different languages. The thesis as a whole argues that Bulgaria had higher level of autonomy than it is usually assumed. In the 1930's this authority was located in its internal politics. In the early Soviet period internal politics were highly dependent on Moscow, but relative authority was allowed on the level of international economic relations and negotiations. The following chapter explains how this was achieved.

Chapter 5: The Transition from German to Soviet Hierarchy 1944-1956

This chapter presents the process of transition from Germany-dominated foreign trade sector to Soviet-Union-dominated foreign trade sector through the lens of domestic change in Bulgaria. It analyses the transfer of German capital in Bulgaria to the Soviet Union at the end of the Second World War, the establishment of the CMEA in 1949 and the first seven years of its operation. The year 1956 marks an important drift between Moscow and the democratic republics of Central and Eastern Europe. Stalin's death in 1953 offered an opportunity for openly challenging the hegemony of the dominant state, which resulted in revolutions in Hungary and Poland and across the region. In Bulgaria events were less dramatic. The personality cult of the Stalinist type leader - Valko Chervenkov, was denounced in 1954 and he was replaced with the moderate Communist - Todor Zhivkov. The so-called April Congress of the Bulgarian Communist Party in 1956 set a new agenda for the socialist development of the country. At the CMEA level the bilateral clearing system also came under revision and proposals for introducing a convertible ruble for multilateral payments made its way into official discussions. Therefore the year 1956 marks the end of the studied period.

Although Communist rule in Bulgaria began with the 9 September 1944 *coup d'état* by Bulgarian Communist resistance movement backed by the Red Army, its official establishment took at least three years until the new constitution of the People's Republic of Bulgaria was adopted on 6 December 1947. Land collectivization was also slow with only about 3 per cent of arable land being nationalized in 1947 and 12 per cent in 1949. The banking sector and all private deposits were nationalized in 1951. Large-scale nationalization advanced in 1950-53.

Unlike these domestic reforms, crucial for the Communist planned economy, control over international trade was the earliest, the biggest most important change after the Communist coup in September 1944 (Kaser and Radice, 1986, vol. 2: 503). State monopoly was established over economic institutions well in advance of the political and ideological monopoly. Thus the second half of the interwar period can be interpreted as a transition period from Capitalism to Socialism in Eastern Europe. This transition was not a process with a determined outcome but happened gradually as a result of state policies in reaction to the Great Depression, the Second World War and the early years of the Cold War.

There is a popular metaphor in the Bulgarian economic history literature (Avramov, 2006) that Bulgaria was “pregnant with Communism” already before the Second World War. This metaphor, however, conceals a qualitative difference between state control in the thirties and state control in the Communist period[51]. In the former the state acted as an agent of domestic interest groups and they considered its role of a foreign trade manager as legitimate in a time when economic nationalism dominated the political imagination. In the latter, control over the economy served the interests of the Communist party, often not the Bulgarian but the Soviet one. It removed the foreign trade professionals from the key institutions and the Bulgarian National Bank and replaced them with bureaucrats loyal to the party. It is true that both periods were defined by state control, but their nature and mechanisms of legitimacy were very different. The legitimacy of the authoritarian

[51] For the main counterhypothesis of this narratine see Ivanov, Martin. 2007. The Miracle of Conception or how Bulgaria ‘Beget with Communism’. *Sociological Problems*, 3-4: 303-337 Sofia: Institute of Sociology, Bulgarian Academy of Sciences.

regime rested on its pronounced nationalist character and the state as an economic agent was seen as a representative of domestic economic interests. The legitimacy of the communist state rested on its devotion to a supranational political goal and service to a center of political power outside its borders was its main source of authority. The continuity of bilateral clearing regime in Bulgaria across the change of hegemonic power and the related with it domestic institutional changes are analyzed in this chapter.

5.1. Transfer of the German Assets to Soviet Possession

As presented in Chapter One global economic conditions were different for Germany in 1929 – 1933 and for the Soviet Union in 1944 – 1949, when they adopted bilateral clearing as the main trade method with Bulgaria. For Bulgaria, however, external economic conditions were similar in the two periods. For the small primarily agricultural Bulgarian economy, which was poorly endowed with natural resources, technologically backward, with a small number of export items, and heavily dependent on foreign markets, maintaining international trade in times of crisis was a matter of survival. Similarly to the shocks of the Great Depression, the end of the Second World War brought about monetary and product shortage and as a result state control over international trade increased even further.

While German authority in the interwar period was based on economic strength, Soviet hegemony was established at the barrel of a gun during the Red Army's march westward as a victor of the Second World War. This has important implications for the kind of hierarchy established. For the period before WWII German authority was legitimized with the expected economic gains for Bulgaria and when expectations were not met, it was challenged and renegotiated. Germany as a rule restrained from direct control over the Bulgarian economy. The German government did not appoint the key figures in the Bulgarian administration; unlike creditors such as Britain, France and the League of Nations, it did not "demand access to Bulgaria's fiscal accounts… did not hold hostage Sofia's tax revenues or insist that debt service should take priority over investment in primary schools" (Tooze and Ivanov, 2011:48). Germany relied on soft power in the interwar period but after 1939 its authority evolved to hard power including a threat of military coercion[52] and the hypothesis that King Boris III was poisoned at Hitler's orders in 1943, which is still unconfirmed to this day.

Soviet dominance on the contrary can be seen as moving from hard power under Stalin to relative softer power under Khrushchev or it was undergoing a "shift from power to authority" (Bunce, 1984:10). Using the "carrot and stick" *parlance*: Germany offered the carrot of beneficial economic cooperation before using the threat of military occupation and actual economic exploitation, while the USSR established its empire with a stick – by placing its army in the country and extracting economic resources first and offered rewards for cooperation later.

Soviet occupation meant immediate and direct control over economic resources and state finances. This was initially maintained through the joint Bulgarian-Soviet

[52] There are different explanations of how and why Bulgaria joined the Axis powers. The most widely accepted explanation in Bulgarian history textbooks is that Germany threatened to invade the country from the northern borther with Romania and that Bulgaria had to choose between occupation and alliance with the Axis. Indeed Bulgaria joined when German troops were already in Romania but Bulgaria's participation was a result of prolonged and tactful negotiations rather than a response to a direct military threat. After joining the Axis powers, the Bulgarian ambassador in Moscow – Antonov was instructed in a coded telegram by the Foreign Ministry to give this threat-based explanation to the Russian government (CPRO, Sofia. F 176 K/21/2614/6). At the same time the Bulgarian ambassador in Berlin – Draganov, warned the Bulgarian government that its joining the Axis should not create an impression of hesitation in the Germans and that it should make sure it is seen as nothing less than wholehearted (Ibid.).

Control Commission, established in 1944 for the management of all German assets in Bulgaria. Later on control was exercised through the Communist government of Bulgaria, which was directly appointed by Stalin and excluded cadres he could not trust. This points to another difference in the nature of authority - unlike German authority, which rested on economic attractiveness, Soviet authority was built on the primacy of political loyalty, which was established with the use of force.

The Soviet empire was not a result of a planned and motivated expansion but rather of a defensive and victorious march westward. While Germany openly claimed imperial rights over the region of Eastern Europe as a necessary economic hinterland to its industrial economy already in 1919 and still before the Second World War (Schacht, 1937), the Soviet Union had no such rhetoric prior to the establishment of the “Eastern bloc” in 1945 – 1948. Janos, 2000 sees the rise of the Soviet Union as follows:

> The political vacuum that had opened up in the wake of the defeat of Germany virtually invited the Soviet Union to perform the functions of traditional *Ordnungsmacht* in East Central Europe even before its hegemony in the area was formally established (Janos, 2000:232).

The region had a primarily security importance for Stalin. First its territorial boundaries were formally established by “reoccupying” and reintegrating into the Soviet Union of all territory under the Hitler-Stalin pact of 1939 (Ibid, 233); nullifying the boundary changes made under German hegemony (with the exception of southern Dobrudja, which Bulgaria “gained as a result of German patronage” and was allowed to retain after 1945 (Ibid.); and punishing the former Axis countries by including parts of their territories into the Soviet Union or into the borders of neighboring Eastern Bloc countries.

Another attestation of the primacy of security was the decision not to transform the countries in East Central Europe into Soviet Republics but to keep them formally sovereign states (Ibid.). This effectively provided a buffer between the pioneer of socialism and the capitalist countries transforming the former economic periphery of Germany into a kind of security periphery of the Soviet Union.

Throughout all these decisions economic considerations came second and the economic component of the new hegemonic regime was formalized no earlier than 1949. The initial economic acquisitions for the Soviet Union came in the form of war reparations from Germany. According to the 1945 Potsdam agreement signed by the Great Powers the German reparations to the Soviet Union were to be settled by means of the German assets in Eastern Europe (Nikova, 1996:419). Control Commissions were established in all East European countries including East Germany. On 20 September 1945 all foreign assets including deposits and outstanding claims of foreign entities in East Germany were placed under the control of a similar commission.

Economic integration with the Third Reich left a considerable amount of German assets in Bulgaria but the Soviet government, which treated them as war trophies, assumed their ownership after 1946. All German assets, mobile and immobile property, shares in German-Bulgarian enterprises, even some Bulgarian items like the three biggest ships became Soviet property (Nikova, 2002). Despite having fought for eight months against Germany[53], Bulgaria was seen as an enemy of the Soviet Union until 1948 when the Agreement for Mutual Friendship and Cooperation was signed.

[53] Between September 1944 and April 1945 Bulgarian troops of 455 000 soldiers joined the Red Army in fighting the Germans in Yugoslavia. The First Bulgarian Army of about 130 000 troops marched further west into Hungary and eventually reached the Austrian city of Klagenfurt aiding the Soviets to push the German Army back (Dimitrov, 1994).

The peace agreement with Bulgaria of 28 October 1944 placed all German assets in Bulgaria in the ownership of the Soviet Union and under the management of the Bulgarian government through an executive office at the Ministry of Trade and Industry. These included most strategic enterprises such as shipbuilding, metal processing and extraction of ferrous metals; the German shares of foreign trade and insurance companies, banks, construction companies, chemical, food-processing and textile factories; the real estates and financial assets of German citizens in Bulgaria. All accumulated Bulgarian claims under the clearing agreements since 1932 or 732 009 155,59 reichsmarks were also transferred to Soviet ownership (Nikova, 1996:422). Deutsche Bank, which was in possession of the clearing documentation, unilaterally canceled all Bulgarian claims, including those against Belgian and Dutch enterprises under trilateral clearing agreements with Germany. German capital investments in Bulgaria, however, were smaller in absolute value than German investments in Central European countries, especially in Poland and Czechoslovakia. The biggest German investments (more than 50 percent of the shares, and in some cases almost 100 percent German-owned) were in the Bulgarian extraction industry, in the shipbuilding and construction sectors. German capital in Bulgaria in 1946 was estimated to have been 1 187 million levs in prewar prices divided respectively among industry – 640 million levs; trade - 201 million levs; banks - 235 million levs and smaller shares in insurance, transportation and other enterprises (Zlatev, 1987:134).

On 31 May 1946 the Bulgarian General Assembly adopted a law, which placed all mobile and immobile assets, trade marks, patents, concessions and shares of German private and corporate entities in Bulgaria under Soviet ownership and made Bulgaria liable to compensate the USSR for the damages incurred by the German enterprises between 1944 and 1946.[54] These reparation payments are hard to calculate because many of them occurred in kind or were calculated under different exchange rates. In a way these payments served as refinancing of the Soviet investments in Bulgaria (Nikova, 1996: 423). Outstanding payments to German enterprises and citizens were to be settled through a transfer of USD 9 000 000, which the Bulgarian government paid to the Soviet Union (Zlatev, 1987:137). Later on this payment was reduced to USD 4 500 000.

German railway engines and wagons which Bulgaria rented in 1941-1943 from the German railway company – *Reichsbahn*, were confiscated as Soviet war trophies and in 1946 bought by the Bulgarian government for the needs of the local railway transport for 1 977 200 000 levs (Isusov, D., Z. Zlatev, eds. 1982: 217). The transfer of German property to the Soviet Union was completed between 1946 and 1948 with the establishment of 159 Bulgarian-Soviet enterprises, under the control of a special Commission for the Management of the Soviet assets in Bulgaria at the Soviet commercial representation in Sofia (Zlatev, 1987:420). This transformation made the USSR the biggest economic partner of Bulgaria. The German-Bulgarian enterprises were eventually transferred under the control of the Bulgarian government in the interim period. Control however only meant that the government made sure the assets stayed in the country while the Soviet mission in Bulgaria had full access to their commercial records and knew which enterprises were profitable and which not.

After 1949 the Soviet Union started selling to Bulgaria the less profitable enterprises while the biggest and most strategic ones were transformed into four

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[54] After declaring war on the USA and Great Britain, Bulgaria suffered Anglo-American air strikes, which damaged many enterprises. During the whole period of the war industrial production in the country decreased from an index of 100 in 1939 to 42.4 in 1944 (Zlatev, 2007:36). The decline was not caused by air strikes alone.

Bulgarian-Soviet companies “Tabso” for air travel; “Korbso” for shipbuilding, which included the German shipyards “Koralovag” and “Neptun”; “Gorubso” undertaking all mining activity in Bulgaria, which was established with the capital of one German mining company and “Sovbolstroi” for construction of industrial and transportation projects, which was based on the capital of four German construction companies (Nikova, 1996:423). Later on in 1954 and 1955 the Soviet shares of these shareholding enterprises at almost 270 million levs were sold to Bulgaria in exchange for in kind deliveries to the Soviet Union over a ten-year period (Ibid. 422). With this all joint companies became fully state-owned and this form of economic cooperation between the two countries was brought to an end.

The foundations of Soviet-style state-owned industrialization were laid not through emulation or practices or knowledge transfer as the German experts operated in the interwar period but through direct Soviet ownership and control. The Bulgarian state can be seen as forced to nationalize its industry in order to transfer its valuable assets to the Soviet Union. As much as socialism is associated with state ownership of production, its origins in Bulgaria are not to be found in an internal democratic revolution but rather in international political intervention[55]. After the initial transfer however, state ownership was fully in line with the interests of the newly established political class. In the new structure of international economic hierarchy state-led industrialization was to become the primary economic activity of the new socialist state while the supply of raw materials and the demand for the industrial output was provided by the central power of the bloc – the Soviet Union. Unlike industry, the foreign trade sector not only shows continuity between the interwar and

[55] For example Mises defines socialism as «the transfer of the means of production out of the private ownership of individuals into the ownership of society» (Mises, 1919:172).

postwar periods but also reflects the small state's preferences for foreign trade regime to a much greater extent.

5.2. From Foreign Trade Isolation to Foreign Trade Reorientation

Until September 1944 Germany had a substantial share of Bulgarian trade (80 percent of the total foreign trade or 71.3 percent of Bulgaria's imports and 89 percent of its exports). However it declined considerably in volume from the previous year and was terminated on 5 September when the Soviet Union declared war on Bulgaria and entered its territory. Bulgaria terminated diplomatic relations with Germany immediately and soon after with Italy. The new government of the Fatherland Front, led by Kimon Georgiev, ended diplomatic relations with Hungary, Slovakia and the Croat Kingdom and as a result Bulgaria found itself in economic isolation from its major trading partners (Nikova, 2002). Foreign trade in 1945 decreased to 7.5 percent of GDP (from 24 percent in 1942 and 19 percent in 1939).[56] The following year trade was predominantly with the Soviet Union. Together "with Romania, it accounted for 85 percent of Bulgarian imports and 97 percent of Bulgarian exports" (Rangelova, 2000).

For Bulgaria the end of the Second World War meant the end of trade with Germany and the beginning of economic occupation by the Soviet Union. In the years 1944-1948 Bulgaria was treated as an enemy of the Soviet Union. According to the truce, signed in Moscow 28.10.1944, it received the status of a occupied country

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[56] Author's calculations of trade openness are based on trade statistics available from Statistical Yearbooks of Bulgaria, various editions and data for the national product provided by Chakaloff (1946) and cited in Rangelova (2000). The formula used is (M+X)/GNP – Imports plus Exports divided by the Gross National Product at current prices for each year.

and organs of direct control over the Bulgarian economy were established by the Allied Control Commission. This commission included representatives of the American, British and Soviet governments but was managed by the Soviet High Military Commission. Major Ilvovsky, a Gosbank bureaucrat, was in charge of the economic section at the Commission and directly controlled the assets of the BNB, Bulgarian Agricultural and Cooperative Bank and the foreign trade (Nikova, 2002:123). Under the same agreement Bulgaria was obliged to cover all expenses of the Soviet Army, stationed on its territory; the expenses of the Third Ukrainian front and the Black sea fleet; the reconstruction of the Russian church and legation in Sofia, which were destroyed during the war, as well as the rebuilding of Sevastopol. A special account called “Expenses arising from the truce agreement” was opened at the BNB; the minister of finance authorized the expenses.[57] During the 1947 currency reform in the Soviet Union Bulgaria was ordered to collect all gold rubles from the population, exchange them for Bulgarian levs and present them to the Gosbank without exchanging them for the equivalent value of the new currency.

Already in the beginning of October 1944, before the signing of the peace agreement with the Soviet Union, Georgi Dimitrov approached Stalin in an effort to arrange export to the USSR of Bulgarian products such as grapes, wine and tobacco against a counter export of fuel, cotton and metals which were in short supply in Bulgaria. Emergency deliveries from the Soviet Union were secured by the end of 1944. After the peace treaty was signed the first trade representative was sent to Moscow in order to negotiate bilateral exchange. The first bilateral trade agreement was signed in Moscow 14 March 1945 after months of negotiations at the highest

[57] The monthly costs in 1945 reached about one fifth of the monthly state budget and decreases in 1946 with the decrease in the size of the Red Army on Bulgarian territory (Nikova, 2002).

state level. Due to its own economic devastation during the war, the Soviet Union was not able to export all of the requested materials and quantities to Bulgaria and Bulgaria agreed to have an export surplus in 1945, to be balanced in the first half of 1946 with Soviet deliveries. This agreement was the first big bilateral clearing agreement between the two countries after WWII. It was the beginning of a quick and total reorientation of foreign trade of Bulgaria from the western capitalist countries toward the Soviet Union and the people's republics.

All trade agreements following the initial one were clearing type of agreements – goods were exchanged against equal in quantity and value goods. When trade was not balanced the difference was transferred to the next year or settled periodically with goods, even when the formal agreement provided for a settlement in convertible currency or gold (Zlatev, 1986:30). Already by the end of 1946 Soviet export to Bulgaria exceeded Bulgarian export to the Soviet Union by 500 000 000 levs and by 1947 its active balance was 788 600 000 levs (Ibid. 33). The goods contracted in 1945 were delivered in no more than a three-year period due to the severe postwar shortages and diminished industrial capacities in the two economies.

The negotiations took place in Moscow over more than three months and can be seen as very successful for the Bulgarian delegation. It insisted that the clearing accounts were settled in US dollars; that some of the Bulgarian exports to the Soviet Union were paid with convertible currency and the prices in the clearing contracts would follow closely the world prices for the respective goods. The main import needs of Bulgaria were metals; equipment for the electrification and the railroads of the country and industrial machines - all capital investments were directed towards the goal of industrialization. The Bulgarian demands were met with approval and clearing and credit payments were settled in US dollars. An agreement was reached to increase the Bulgarian export prices, that of tobacco was 91 percent higher in 1946 than in 1945; of fruit pulp 54 percent of copper ore 75 percent higher (Zlatev, 1986:47). The total index of import prices from the Soviet Union was 98.08 percent in 1946 at a 100 percent base in 1945 and the index of export prices from Bulgaria to the Soviet Union was respectively 142 percent of its 1945 level in 1946 (Ibid.). The Bulgarian delegation reached this improvement of its terms of trade on the grounds that the 1945 prices were disadvantageous for the Bulgarian economy. Alongside the general trade agreement between the two countries many other small agreements were signed. While granting political loyalty to Moscow, the new communist government of Bulgaria managed to improve its immediate economic condition.

Foreign trade became regulated with a strict license regime; the ministry of trade approved the enterprises that could undertake export and import activity and decided on its structure and direction (Nikova, 2002). Directorate of foreign trade in the Ministry of Foreign Trade and Supplies brought under its control the foreign trade enterprises like Bulgarian Import Central, Bulgarian Trade, Bulgarian Industry, the Import Central for Petrol, Bulgarian Agricultural and Cooperative Bank, Hranoiznos and Cooperation United Centrals. Until 1947 353 private enterprises were granted a license for import and 290 for export (Nikova, 2002).

With the Peace Treaty, signed 10 February 1947, Bulgaria's foreign trade expanded to more markets, greater variety of goods were imported and the share of capitalist countries among Bulgaria's trading partners increased. In 1947 and 1948 agreements for friendship, cooperation and mutual assistance were signed with the USSR and the other people's republics. In March 1947 the Council of Ministers adopted a series of measures, which put foreign trade under state control. Most state-owned enterprises dealing with foreign trade were created at the same time.

These were “Bulgarplodexport” for the export of fresh and processed fruits and vegetables and spirits; “Bulgartabak” - the monopoly enterprise for the production, purchase, processing and export of tobacco and tobacco products; “Bulgarroseexport” for export of rose oil; “Rudexport” for the export of minerals; “Chimimport” and “Metalimport” for the export of chemicals and metals respectively. They had exclusive monopoly rights over trade with their designated products. The majority of shares in “Bulgarplodexport”, “Bulgarindustrialexport” and “Industrialimport” were held by the state but other shareholders included the Central Cooperative Union and the private exporters in the respective sectors. The law did not grant a monopoly to these three enterprises but in practice trade was concentrated in their hands. The export of eggs and leather was done by a monopoly company. All factories and warehouses belonging to the respective monopoly sector became state property by law (Nikova, 2002:132). In 1947 private companies still had the bigger share of the import sector and supplied the state-owned enterprises with imported raw materials.

On 28 March 1947 the government adopted a law for the “Fund for the equalizing of prices.” This was the tool for the administratively setting the prices on the domestic and international markets and the relationship between them. Another ordinance of the Council of Ministers adopted on 26 July 1947 made all import orders for metals and machines compulsory through the import monopolies “Metalimport” (Ibid.). The imported goods were further distributed internally by the Ministry of Trade and Foodstuffs (Ibid.133). The state practically nationalized most of international trade well in advance of the nationalization of agriculture and the financial sector. Similarly to the interwar period this institutional change came about incrementally through a series of separate laws, not like in the Soviet Union by means of a special law (Ibid.), which shows that it was a result of adjustment to change rather than a manifestation of ideological conviction.

The ruble became the currency of international exchange with a decision of 18 February, 1950 and replaces the dollar at a rate of 5.30 rubles per dollar. All credit payments were revaluated in rubles. In the whole period between 1949 and 1954 foreign trade with the Soviet Union grew exponentially, timing of the deliveries improved and export-import structure became more diversified. External factors like the decline of exchange with the capitalist market also fostered these close relations (Zlatev, 1986:131). By 1952 the trade reorientation towards the Soviet Union was complete. As evident from table 14, the USSR comprised a large share of each country's foreign trade and the whole of the Eastern bloc took more than three quarters of each country's trade.

Table 14. Trade Patterns of Five East Central European Countries, 1937 - 1952

Trade Patterns of Five East Central European Countries, 1937 – 1952 (percentage of foreign trade)				
	With USSR		With CMEA (Bloc)	
	1937	1952	1937*	1952
Czechoslovakia	1	35	11	71
Poland	1	32	7	67
Hungary	-	29	13	71
Romania	1	58	18	85
Bulgaria	-	57	12	89

Source: Janos, 2000:235 from Spulber, 1957, 410.
*With USSR and the five countries listed.

The trade reorientation toward the Soviet Union was not isolated from the global conditions, most importantly from the economic embargo applied by the West to Bulgarian goods, which were relatively competitive on the capitalist market. Additionally, geographic proximity, despite the bad transport infrastructure, played a positive role in extending trade relations to the east. The political motives were extremely important. The process of establishing this new trade regime took place amidst the thick political propaganda of the guiding principles of equality, mutual benefit, mutual assistance, negotiations, specialization of production and exchange, coordinated planning (Zlatev, 1986:31). According to the official propaganda the main difference between the socialist world market in the making and its capitalist competitor was said to be the non-intervention in the internal affairs of partner-countries as opposed to the stated exploitation of the small by the big countries inherent in the capitalist system. In fact the socialist system did not refrain from intervention but intervened in a different way, namely through direct control over the personnel, by appointing managers and assigning policy objectives.

5.2.1. The change of personnel

The Soviet Union exercised strict control over personnel decisions. Janos, 2000 makes the following comparison:

> [f]irst secretaries were appointed and dismissed directly from Moscow and all appointments at the Politburo level had to be cleared with the Soviets. This was a major difference between the Soviet and earlier hegemonies, including the more inchoate imperial hegemony of Germany before and during World War II" (Janos, 2000:234).

On orders from Moscow and directly from Georgi Dimitrov many high level officials were sentenced to death on charges of state treason. The purges did not spare lower level experts in the state administration who were dismissed simply for not being members of the Communist party. The actual executions, however, were in the hands of local officials and different countries in the region had a different degree of personnel cleansing. The number of death sentences issued by the new People's courts varied considerably, from around 300 in Hungary to 2730 in Bulgaria. Many of the Hungarian experts, removed from office initially, were later restored; some were brought directly from the prison cell to the Ministry of Trade[58]. In Bulgaria continuity of executive personnel is hard to find.

The blocked reichsmarks in the German clearing account (738 million reichsmarks or 2 430 051 million levs, Nikova, 2002) constituted a credit to Germany never to be repaid – a monetary loss which the new Communist government of Bulgaria assigned to the central bank. Its management was accused of acting in support of Nazi Germany beyond the requirements of the clearing agreements. Long-time governor, minister of finance and prime minister Dobri Bozhilov was prosecuted for political and economic crimes against the state; found guilty by the People's Court[59] and executed in early 1945. At the prospect of similar fate upon returning home, the commercial representatives in Berlin, Paris, Bern and Warsaw decided to remain abroad (Nikova, 2002:121). The degree of the terror applied by the new government can be seen as proportionate to the loyalty to Moscow it aimed to signal.

The Stalinist model of political economy in fact relied on allegiance to Moscow. It can be described as:

> …state ownership of the means of production, central planning, collectivization of agriculture, and rapid industrialization, both through controlled consumption and through the funneling of considerable forced savings into heavy industry. On the political side Stalinism involved the concentration of resources in the hands of a totalitarian party and the use of terror to destroy old allegiances and power structures, force allegiances to the new order and further concentrate power in the upper reaches of the party – and in particular of those trained in Moscow and obedient to Soviet wishes (Bunce, 1985:5).

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[58] I am thankful to Bela Greskovits for discussing this issue with me during the 2011 Annual Doctoral Conference at CEU. He brought to my attention the continuity of personnel in the case of Hungary some experts who had been initially imprisoned were soon restored to office in order to continue working in the ministry of foreign trade.

[59] The People's Court was established by the Fatherland Front; on January 1945 it found guilty and sentenced to death all ministers from the wartime cabinet.

The fusion of the economic, political and social arenas as described by Bunce, 1985 was the mechanism of empowering and influencing the political elites in the people's democracy. In this new domestic regime trade and economic cooperation between Bulgaria and the Socialist bloc countries had to be organized in a new different way and coordinated by new institutions – the New Ministry of Foreign Trade and two additional export enterprises "Raznoiznos"[60] and "Hranexport"[61] and required a complete change of the foreign trade personnel. All previously employed experts - directors of foreign trade companies and heads of administrative units were replaced with Communist party members regardless of their lack of experience in foreign trade activity. The president of the Union of Bulgarian Exporters – Hristo Yotsov, together with the members of the governing council of the Import Central were arrested at the end of 1944 and questioned by economic police, later released but permanently removed from leading positions in the sector.

A report of the Council of the Ministry of Foreign Trade in 1949 shows the radical attitude towards professionals from the interwar period. It criticized the fact that some executives were excluded from the Communist party but retained their administrative positions due to high competence and experience in the pre-1945 ministry (CPRO, Sofia, F 259 K/9/7: 7). The question of the "political upbringing" of cadres was discussed at the highest level and as a result old professionals were replaced with young Communist activists, who had proved loyalty to the Bulgarian Communist movement in the interwar period. In 1985 on the occasion of the fortieth anniversary of socialist trade of the People's Republic of Bulgaria a two-volume book of memoirs of high-ranking officials was published. In it Boris Hristov – the foreign

[60] Translates as «any export».
[61] Translates as «food export».

trade representative for Bulgaria in Moscow between 1944 and 1949 writes that the Soviet delegates, Soviet Trade Minister Mikoyan, the deputy commissioner for foreign trade Stepanov and the trade representative in Bulgaria – Zajtsev, had considerably more experience compared to the Bulgarian trade representatives, few of whom had dealt with foreign trade before and were in general young and learning ("Forty years Socialist Trade of the People's Republic of Bulgaria, Memoirs", Sofia, 1986:11). Dobri Aleksiev – a deputy minister of trade 1949-1952 recalls his own appointment:

> In August 1949 I was summoned by the secretary general of the Central Committee of the Communist Party - Georgy Chankov and the minister of foreign trade Dimitar Ganev and I was offered the position of deputy minister of foreign trade. Ten days later the decision was published and I found myself in the international trade sphere having neither the necessary preparation and background nor specialized education. It was learning by doing (Ibid., 26).

Zhivko Zhivkov – deputy minister of foreign trade in 1950 and minister of foreign trade 1952-1957 also acknowledges the "sharp need of qualified foreign trade cadres, to take control over the socialist foreign trade. The old professionals from the capitalist period were gone" (Ibid., 48).

Grigor Popisakov – a professor of international trade and finance, comments in his memoir on the pressing need of qualified personnel to manage the foreign trade enterprises. At first the responsible administrators completed qualifying course at the ministry of trade and the enterprises including language courses and later in 1951 the economic faculty of the Sofia University opened a new discipline "International Trade" in order to educate the new generation of professionals for managing the international trade enterprises. The faculty also consisted of "young academics" (Ibid, 107-108). The process of establishing this faculty and its production of qualified cadres took a few years during which students, faculty and scientific research in the sphere of international trade was taking its new shape and form in compliance with the ideological frameworks of the new regime.

Archival documents also reveal that the organization of trade was close to chaotic. Deliveries were shipped in the wrong quantity, ordered items were missing or were not addressed to the correct department, quality specifications were not observed; packaging was not of the appropriate kind and durability; chemicals imported from the Soviet Union were not of the expected concentration (CPRO, Sofia, F 445/1/73/214). Additionally, goods were sent without invoices, which made their correct pricing at the domestic market very difficult (Ibid.: 202). The documentation was not always translated in the language of the importing capitalist country, which caused the Ministry of Trade to issue an ordinance that documents to the capitalist countries should be written in the language of the country (CPRO, Sofia, F 356/1/119/86). In 1948 wooden crates were constructed last minute and by unqualified personnel, not carrying the name Bulgaria, but most of all they were unfit to preserve the goods during transportation. One example is the export of apples to Poland.

The Polish foreign trade enterprise complained of the bad quality apples from Bulgaria; the price for Bulgarian apples was in addition higher than if they bought them from Switzerland or Hungary and the only reason why they were accepted was that the Polish ministry of foreign trade had ordered them to. As a result the Polish enterprise deducted their costs for handling the bad quality produce and Bulgarplodexport received a lower price for the exported apples. The Bulgarian representatives in Warsaw in a report to the Ministry of Trade admitted that the Polish claims were justified and that Romanian apples were better packed “like eggs” and were obviously of higher quality (CPRO, Sofia, F 445/87).

This was no accident but the standard practice because the highest quality goods were directed to the free exchange market with Sweden, Austria, England, West Germany buying the best quality tomatoes and grapes but on those markets the Bulgarian goods faced tough competition and received lower prices than on the socialist market. Although these goods were sold at low prices even at a loss they were a source of convertible currency. The lower quality goods were reserved for domestic consumption in Bulgaria and export in the CMEA bloc.

The archival documents confirm the hypothesis of the two-dimensional model of CMEA trade, which shows that if trade between members of the bloc were not constrained politically it would be equal to zero (Bergson, 1980:303).

As a result of incompetence the foreign trade sector worked at a loss and became increasingly inefficient. The ten foreign trade enterprises were the main agents of state planning for import and export. Those were “Rudmetal”, “Metalimport”, “Industrailimport”, Bulgarplodexport”, “Chimimport”, “Hranexport”, “Bulgartabac”, “Raznoiznos”, “Balkanturist” and “Despred”. Bulgarplodexport, established May 23, 1948 was the direct offspring of the Union of Bulgarian Exporters analyzed in the previous chapter (CPRO, Sofia, F 356). The central committee received many complaints that it had not communicated the contract with the USSR clearly and that it had accepted imports before securing buyers for them. All the losses from trade were calculated as a special category – “planned losses” which were reported every month by the foreign trade enterprises and covered by the Ministry of Finance (Ibid.). The Ministry of Foreign Trade had a common practice to transfer the losses from export to the capitalist countries onto the price of the imported goods.

A 1953 report of Mr. Zahariev, department of price-setting at the ministry, reads that this practice hinders the activity of the export enterprises and proposed that the export losses be covered by the state budget while the prices of the imported goods be coordinated with the prices on the domestic market. The Minister of Trade issued an ordinance N.525 of 04.12.1952 that all applications for an export license should include the real cost of the exports, the real market price, the difference between the two (positive or negative), the planned loss and unplanned loss that may occur above the planned one, where the reasons for the unplanned losses and the sources for their payment should be identified (ibid. 126).

The change of personnel had a direct economic cost. Estimated losses from all exports of Bulgarplodexport were approximately between 3 and 9 million levs for a period of a week to ten days, which were covered by the state budget. Some of the losses were due to destroyed produce others due to untimely expedition of the exports costs related to bureaucratic mismanagement [62] (CPRO, Sofia, 356/1/144).

5.2.2. The changes of trade structure

International trade between Bulgaria and the Soviet Union resumed after 1935 when diplomatic relations between the two countries were established. However there was no trade agreement between the two countries and exchange was facilitated through third party intermediaries and commissioners, which increased the costs of trade.

[62] There is evidence of exorbitant telephone bills for calls to the Soviet Union, especially high-speed and lengthy calls for about 50 000 levs (Ibid.p 97). At the same time no high speed or priority calls have been dialed from the Soviet Union to Bulgaria. The Minister of Trade ordered the employees to send telegrams instead and conduct focused and concise phone calls when needed (Ibid.).

The Ministry of Trade was repeatedly approached by Peter Taushanov[63] – who was interested in becoming a Bulgarian trade representative in Russia, advocated for the establishment of a Bulgarian foreign trade agency in Moscow and promoting regular trade and payment relations between the two countries (CPRO, Sofia F 176K 1/1202).

The opportunity he pointed at was only realized in 1940 when trade dependence on Germany was already over 80 percent of Bulgaria's total trade and the government made an effort to diversify its trading partners. On 5 January 1940 a trade and payments agreement was signed between the governments of Bulgaria and the Soviet Union. All payments were advanced through a non-interest bearing clearing account in levs at the Bulgarian National Bank. The export and import licenses were to be granted immediately for a number of goods listed in an appendix with their prices but not quantities. The USSR was to use freely the sums in its clearing account for purchases in Bulgaria including for payments of its diplomatic service (CPRO, Sofia, F 176/11/1830/1). The value of imports equaled the value of exports and was fixed at 460 m levs for the 1940 agreement (ibid., 2). The agreement included a clause 5 that all payments be transferred immediately. Both central banks were obliged to pay the creditors of the clearing accounts as soon as the payment documentation was presented, irrespective of the available funds in the accounts. Thus they would extend interest-free credits to each other, which were to be cleared within six months with a counter export of goods for the same value. Instead of allowing for free exchange to be used for the import of raw materials the

[63] Born 1881 in Svilengrad, studied at Odessa Orthodox Seminary and lived in Russia; had close connections with the Russian Bolsheviks and is active after the October revolution 1917. In 1932 returns to Bulgaria advocates closer trade relations with the USSR and proposed to be nominated a trade representative in of Bulgaria in Moscow (CPRO, 2003: 409).

USSR delivered these materials directly to Bulgaria (ibid.). The agreement, if not terminated, was to be renewed the following year. The USSR was allowed to use all of its blocked assets for purchases in Bulgaria and for that purpose the Bulgarian Central Bank and all relevant authorities were to issue the needed documents without delay.

A secret trade agreement between Bulgaria and the USSR, which was very similar to the German clearing and trade agreements, was signed on 14 March 1945 (Avramov, ed. 2004:1090). A new clearing agreement with the USSR was signed in Moscow on 27 April 1946. The corresponding accounts were settled in US dollars at fixed exchange rates for different goods. In 1952 the lev was tied to the clearing ruble, which replaced the US dollar in clearing settlements among socialist countries (Avramov ed., 1999).

By the end of 1946 the Soviet Union accounted for 80 percent of total Bulgarian foreign trade followed by the GDR and Czechoslovakia, which exported mainly industrial equipment to Bulgaria. The second place of Germany is due to the complementarities of the economic structures of the two countries; the same is valid for Czechoslovakia. For the first three years Bulgaria had a trade deficit with these countries because of its diminished export capabilities. During the first five-year plan 90 percent of total import was machines and industrial equipment, petrol, mineral ores and metals; raw materials (except foodstuffs) chemical products, fertilizers and rubber. These were largely the same types of goods Bulgaria used to import in the 1930's from Germany. The export structure changed considerably compared to the pre-war years. While in 1939 the export of agricultural products was about 80.4 percent of the total export, in 1949 it was 62.7 percent and at the end of the five-year plan 54.5 percent (Nikova, 1989:142). There was a notable increase in the export of processed food, mineral resources and some machines. In the years 1951-52 Bulgaria experimented with the export of cotton, some chemical and pharmaceutical products (Ibid.). Tobacco and foodstuffs continued to have an important place in Bulgaria's export although not a primary one.

The BNB continued its monopoly over foreign exchange transactions as stipulated by the new law of 3 May 1945 and its final text adopted on 1 August 1946. By means of this law controls over currency possession and transactions increased and the sanctions for violation were as severe as imprisonment for up to five years. The central bank was also empowered to have its own inspectors register violations of the respective law. BNB inspectors' reports were considered a legal evidence of proof (BNB 2004:1106). These measures were far more severe than any controls in the interwar period.

5.3. The Origins of the Council for Mutual Economic Assistance

The period 1944-1956 is the first phase of the evolution of the socialist clearing regime established formally with the founding of the Council for Mutual Economic Assistance on 25 January 1949 and marked with the decision to multilateralize the system in 1956. This decision, although not implemented in practice until 1964, and scarcely even after that, acknowledged the limitations of the bilateral system and the political will to overcome them without however reforming the socialist system of price setting. A plan to introduce the transferrable ruble was adopted in 1956 and although there were efforts to introduce multilateral payments in both the Nazi and the Soviet cases, the two systems functioned primarily as bilateral clearing regimes.

The CMEA had an important role for the building of the socialist bloc. Alongside the authority and security hierarchy it allowed for economic integration between the people's democracies although not according to the comparative advantages of the different states. In the comparative economic systems literature the bloc is approached from the point of view of its efficiency. Similarly to the criticism of the clearing system, the planned economy is seen as an inefficient way of organizing trade, which hinders flexibility and international specialization according to comparative advantage. One thesis is that the CMEA as a whole is managed in the same way as the domestic planned economies and that the domestic economic relations are transferred onto the international level.

Another set of debates concerns the level of economic integration between the socialist countries. One argument is that the CMEA was an organ of Soviet control over the rest of the socialist republics through a central plan; another one is that there was no central planning at the international level and that trade was assigned by means of bilateral negotiations.

Bergson, 1980 finds that if trade was conducted at world prices the East European countries would be trading at a loss, while for the Soviet Union would prices of exports would have been more beneficial or "the terms of trade between the USSR and the EE (Eastern Europe) are less favorable to the USSR and more favorable to EE than world prices" (ibid.). It is interesting that the same argument was used for the bilateral clearing trade of the interwar period and the bilateral clearing trade of the socialist bloc – such trade is marginally better than no trade at all. If the Soviet Union was found to have lost while trading with Eastern Europe, the terms of trade debate on Germany in the 1930's had no such finding. Both hegemons deliberately isolated their economies from trade and financial relations with the West, but while realized economic gains Germany, the Soviet Union made marginal economic loss. This however is estimated only for trade between a East European country and the USSR. In trade with each other the socialist countries may have incurred losses rather than gains on both sides of the same trade transaction.

Another aspect of the socialist bloc trade is the often practice of the East European countries to sell to the west and in exchange for convertible currency products they imported from the Soviet and goods from processed such products. Such arbitrage was widely practiced by Germany in the interwar period and Bulgaria in particular protested the reexport of its tobacco.

On the case of Bulgaria there are two rival arguments – that Bulgaria enjoyed a preferential economic terms by the USSR in exchange for its loyalty and the understanding that Bulgaria was politically very dependent and exploited just like everyone else by the USSR. Bulgarian historian Gospodinka Nikova argues that the main purpose of the CMEA was the coordination of economic policies among its member states which comes down to coordination of their economic plans (Nikova,1989)[64]. The name of the institution that was proposed in the preliminary documentation was “Economic Coordination Committee” but the one adopted officially and announced in press on 25 January 1949 was Council for Mutual Economic Assistance (Ibid.27).

The reconstruction after the war and the counterforce of the Marshal Plan played an important role for the ideological consolidation of the bloc as an opposition to the West. The official Soviet propaganda was that the Marshal plan was unacceptable to the socialist republics because it threatened their sovereignty. The

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[64] Nikova and Zlatev have done the most extensive archival research on the topic of trade and economic relations between Bulgaria and the Soviet Union and I use their works as the main refence to primary sources available in Bulgarian.

CMEA was not built on a theoretical prescription and in fact there was no clear theoretical model of socialist cooperation prescribed by the Communist ideologues and not much theoretical legacy from Marx and Lenin on the issue of international trade under socialism. With the exception of Czechoslovakia and East Germany the countries of the region have not traded extensively with each other due to the similar export structures of their economies. Czechoslovakia as the most industrialized of all had the most diversified trade with the rest of the region. The Soviet Union was in a long-lasting economic and diplomatic isolation from the rest of Europe before the Second World War. International trade among east European countries was about 10 percent of their total trade and their trade with the USSR was about one percent (Nikova, 1989:38).

In the first years of the CMEA before the process of nationalization was completed foreign trade was mostly organized by private enterprises. This made it difficult to coordinate foreign trade according to the plan. However, the majority of “economic assistance” activities that took place within the Council were indeed international trade deals. After the Second World bilateral clearing, which was inherited from the capitalist system started functioning in a slightly different way. The new aspect was the abolition of the clause for the yearly balancing of outstanding debts with convertible currency or gold. Export surpluses were treated as short-term credit in kind that could be paid back in the following year with a counter export of goods (Nikova, 1989:42).

The bilateral agreements for friendship and cooperation between the Soviet Union and Czechoslovakia, Yugoslavia and Poland were concluded already during the War while with Bulgaria Hungary and Romania they were signed in 1948. All countries signed such agreements with each other in the period 1946-1949 which provided the framework of economic cooperation (Ibid. 46).

The alternative framework for postwar reconstruction of Europe, the Marshal Plan, was seen by the Soviet Union as an attempt of the United States to control the economic policies of weaker countries by means of its currency. While France and Great Britain advocated the inclusion of the Soviet Union in the Marshal Plan in order to avoid a political split of Europe, Moscow suspected that the American proposal to join was merely hypocritical and declined further negotiations. The Soviet opposition was based on the concern that the plan would be managed by the leading European Economies - Great Britain, France the Soviet Union and not more than four other countries, which would subordinate the small countries to its economic policy and disregard their autonomy.

The Soviet counter-proposal was for the inclusion of the smaller countries especially those that were most damaged by German occupation. However, this proposal proved only rhetorical when on 12 July 1947 the French government initiated a new round of negotiations, to which 22 European countries were invited and the Soviet Union declined the invitation. Greece, Turkey and Czechoslovakia were the only East European countries to accept the invitation but Czechoslovakia later withdrew from it under the pressure of the Soviet Union (ibid. 51). As a result the International Bank for Reconstruction and Development cancelled the funding promised to Hungary, Czechoslovakia, Poland and others. The Bank justified its decision with the concern that the Polish government acts under the influence of another power and is not free to decide on its commercial policy. The exclusion of Eastern Europe from the Marshall Plan and the institutional framework for economic cooperation in postwar Europe clearly delineated the sphere of influence of the

Soviet Union and made Eastern Europe dependent on Soviet economic assistance. The USSR extended reconstruction credits in kind and in rubles at lower interest rates than the market rates for dollar loans. The result was the division of Europe into two rival political and economic spheres. The signing of the Warsaw Pact in 1955 provided the security dimension to this partition.

5.4. Institutional Framework of the CMEA

The council for mutual economic assistance was founded by Bulgaria, Czechoslovakia, Hungary, Romania, Poland and the USSR on 25 January 1949 as a regional economic organization (Balassa, 1992:3).[65] Two representatives from each country were selected for the bureau in 1949. Its structure and functions were directed by a series of separate decrees until 14 December 1959 when its official statue was adopted at the twelfth session in Sofia (Fadeev, 1975:63). Sectoral commissions were not created until 1956. The CMEA session was the highest organ discussing main issues and choosing directions for future development. Each member country was represented in the session by its delegation. Presiding over the session was the leader of the hosting delegation. Its active organ - the bureau, consisting of one representative of each member state and the technical assistance to it, was situated in Moscow. The decisions of the bureau, deciding on internal economic policy, had an advisory function until the nation states' governments

[65] Yugoslavia protested its exclusion from the organization to which the Soviet Union explained that CMEA is not an organization for regular economic cooperation but an exclusive organization for broad economic cooperation among friendly states, which conduct honest and fair policy toward each other to which Yugoslavia can become a member only after it abandons its hostile policy and returns to the policy of friendship. Similar replies were sent to Yugoslavia from Sofia, Bucharest, Budapest, Prague and Warsaw, which clearly indicated the political nature of the newly formed organization.

formally adopted them as laws.

In the early period (until 1953) the institutional structure was fairly simple and cooperation was based primarily on bilateral agreements. The aims were stated broadly as economic cooperation, technical assistance, exchange of expertise and mutual aid for securing raw materials, foodstuffs, machines etc. (Nikova, 1989:60). “Equal treatment” was one of the founding principles for achieving the ultimate goal of coordination of national economic plans (Ibid.).

The economic priorities defined at the first session of the CMEA 26-30 April 1949 and included in the first five-year plan were industrialization understood as electrification and developing the extraction industry, machine-building, chemistry and metallurgy (Ibid., 62). The first attempt at specialization was made during the Second session - 27 August 1949 in Sofia, where Poland, Hungary and Romania were advised to increase the production of ball-bearings and to coordinate raw materials supply among member states for the period 1950-1953. Other discussed projects were the development of energy production and irrigation facilities and transportation and industrial production units (ibid., 63).

By the time of the formal establishment of the CMEA Bulgaria was already on the same path of Stalinist type economic development with communist party members at the head of the state and considered a loyal ally of the Soviet Union. Georgi Dimitrov’s unique relationship with Stalin and undisputed influence over Bulgarian politics secured obedient behavior of the Communist Party and warm relations with Moscow. Moving from hard military power to building a bloc of “fraternal states” and especially after leaving the Marshall Plan negotiations, the Soviet leadership entered rhetoric of equal treatment of all members of the CMEA. As a founding member, Bulgaria had a direct access to the institutional design of the

CMEA and although a distrusted partner initially, it was allowed to influence the rules of the international trade regime.

At the founding meeting of the CMEA the Bulgarian delegation expressed a concrete concern about the international price of tobacco, which Bulgaria exported to the socialist market. The bloc countries treated tobacco as a weak good[66] and were not willing to export machines in exchange for it. In addition American tobacco was imported in Europe, which threatened with bankruptcy the Bulgarian producers. Compared to the American tobacco, Bulgarian one was more costly to produce and of lower quality, therefore it was not competitive on the world market. However tobacco provided the employment of whole regions in the country.

The Bulgarian delegation demanded that the CMEA adopted “fair prices” for trade among socialist countries (Nikova, 1989:129). The prices on the world market served as a benchmark for prices in the CMEA trade. Bulgaria argued that the production costs for some of it s export items were higher than the world prices and that at the current stage of its economic development Bulgaria could not decrease its production costs without driving the rural population into bankruptcy. Based on these arguments the Bulgarian delegation insisted that the CMEA sets its prices at a higher level than the world prices.

On the point of organizing multilateral clearing system the Bulgarian delegation expressed the opinion that it was too early to adopt multilateral clearing in 1949 that the bloc would need to accumulate more experience before making this step. They also insisted on setting a firm base for estimating the exchange rate of each country’s

[66] In CMEA negotiation export items that could earn hard currency were termed hard goods and those that could only be sold on the socialist market were termed soft goods.

currency (Nikova, 1989:129). Both propositions of Bulgaria were satisfied and adopted by the Council.

The second session of the Council decided that trade should be organized on the basis of long-term agreements. However, in practice most of the trade of Bulgaria was based on agreements for up to one year (Ibid., 131).[67] At the same session the Council discussed the question of international payments, which until then had been based on different currencies. From 1950 the gold soviet ruble became the main unit of account for the bloc. This meant that all outstanding payments in US dollars had to be recalculated in Soviet rubles. The dollar-ruble exchange rate was administratively assigned and resulted in overvaluation of the ruble. At this recalculation Bulgaria's debt payments decreased considerably allowing the country to import more from its creditor - the Soviet Union. Such artificial stimuli are very similar to the German trade polices of the 1930's and are examples of tangible economic benefits secured by Bulgaria.

The Council also provided a recommendation that import from the capitalist countries should be restricted to the most deficient goods, in order to avoid spending hard currency and import from within the bloc should be prioritized. The latter were goods of far lower than western quality levels and selling them for free foreign exchange was not an option. A commission for the coordination of foreign trade of the CMEA countries with the capitalist world was established in each member country. The purpose of this commission was to use in a most effective way opportunities to export and import in the capitalist countries while coordinating and minimizing any potential competition between bloc members for foreign markets.

By 1953 extensive industrial development had created serious shortages of

[67] Only with Czechoslovakia and Poland there were long-term agreements.

consumer goods and agricultural products for the working population. Agricultural production was also lagging behind in both output and technological level. The bilateral clearing system of trade with the Soviet bloc provided an opportunity for secure and vast foreign markets for the Bulgarian goods and in exchange - uninterrupted supply of raw materials and energy resources.

While coordination of production plans resulted in disproportionate development of certain sectors to the expense of others; excess of low quality and expensive industrial production and shortage of consumer goods and food, international trade remained the main field of socialist economic cooperation until 1956. The agreement at the founding session of the CMEA was that it would control the implementation of the export-import plans for the priority items in each country's foreign trade; it would coordinate the plans for developing international transport and transit routes.

At the third session of the council in 1950 the CMEA countries adopted a fixed price policy based on the prices in the previous year, which replaced the previous practice of using the prices of the capitalist world market as a reference. This allowed the planning of foreign trade not only in terms of kinds of goods but also in terms of value.

The coordination of national plans for import and export proved more difficult that initially envisioned, especially in the case of trade between countries with similar economic structures such as Bulgaria and Romania. The countries took time to research and prioritize their own needs and the needs of partner countries. Matching national interests, needs and possibilities was not a smooth process. Unlike the previous regime where the economies of Bulgaria and Germany easily found a complementary structure on the basis of which to develop, the socialist market took more time to define a mutually acceptable division of labor. This resulted in chronic deficits and surplus production. Very often the plans for export of one or several countries did not match the plans for import of other countries both in quantity and in the kind of goods offered. The lack of convertible currency, especially in the case of Bulgaria, was a serious impediment to purchasing the needed items on the world market.

The situation was even more complicated than during the trade with Germany and the Bulgarian administration was not an efficient organizer and manager of international trade. In order to balance the trade surplus Bulgaria had to import goods outside the plan, which had little application in the Bulgarian economy and were usually, re-exported.

The export of industrial goods reached 50 percent of total exports in 1955 and consisted of more than 600 items (Nikova, 1989:163). An important item of Bulgarian export were lead-zinc and copper concentrates, iron manganese, pyrite and other ores. From 1955 the extraction and export of Bulgarian petrol began (Nikova, 1989:164). Other new export items for the Soviet Union were cotton, silk and wool textiles, shoes, furniture, glass and porcelain products and ceramic tiles. In 1955 Bulgaria started to export penicillin, washing soda, caustic soda and other products of chemical industry, which it until then imported.

In terms of export negotiations GDR, Czechoslovakia and Poland continually demanded that Bulgaria exported more grain and fodder, but Bulgaria did not agree to increase these exports because this would endanger the population's food supply. After the Soviet Union the second and third biggest importers to Bulgaria were the German Democratic Republic and Czechoslovakia. From Czechoslovakia, Bulgaria imported transportatio equipment, equipment for water electric plants and from East Germany, sawing and weaving machines for the textile industry refrigeration installations and milk-processing facilities chemicals, paints and fertilizers.

Conclusion

It is commonly asserted in the literature that the trade between the USSR and the East European countries was costly for the East European countries in the beginning but became more advantageous during the late 1950's and 1960's. Bunce, 1985 finds that "Soviet returns from empire were remarkably close to the ideal during the Stalinist period". This means that the Soviet Union was in a position to realize economic benefits from it. With time, however the empire became a burden and a liability to the USSR. The present chapter demonstrated that by adopting the bilateral clearing trade regime and deciding to trade not in world prices but in more advantageous "fair prices" the people's democracies secured access to cheap resources and export markets for their goods at overpriced rates from as early as 1949 and for many decades to come.

It was demonstrated on the case of Bulgaria that in the early years after the end of the Second World War "the USSR was receiving unrequited exports from E[astern] E[urope] in the form of reparations" (Bergson, 1980:305). However, at the establishment of the new international trade regime all members of the CMEA were involved and their interests were reflected in the new organization. They were not allowed to join the Marshall Plan, but unlike in the German sphere of influence where rules were unilaterally set by Berlin, the CMEA was formally established with the participation as equal members of each socialist country. It was surprisingly Bulgaria – one of the small and less developed member countries, to have its preferences embodied in the new institution.

The years of bilateral clearing trade with Germany had taught the lesson of arbitraging between trade regimes. The continuation of bilateral clearing after ridding the state administration of any old regime personnel was a choice made at the highest level of international economic negotiations and one of formative and lasting effects. The transfer of authority from Germany to the Soviet Union was not possible without this change of personnel and without the new communist cadres ready to swear allegiance to the center of power in Moscow. Being a devout communist was not sufficient to remain at a high administrative or government position but being obedient to Stalin even when his demands were against the national interest of the small state was a necessary condition[68]. Show trials, pogroms and terror established unprecedented control of the domestic politics in Bulgaria.

At the international level however, the Soviets had to demonstrate that they treat the countries of the region as equal partners in contrast to the “exploitative methods of western capitalism”. They allowed some international autonomy of the small countries by taking their preferences into consideration and building the new regime on the basis of rules of their choice. Whether this was done intentionally or by chance is not the question of this research but research on the later periods of CMEA show that these rules proved very rigid. Looking at the terms of trade of the Soviet Union they were continually worse at CMEA prices than at world prices and on this parameter the East Central European countries can be seen as benefiting from their trade with the USSR. Political loyalty was in other words purchased with discount deliveries of raw materials and securing above world market prices for goods of lower quality and competitiveness.

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[68] A convicing example was the trial and execution of Traycho Kostov in 1949. Kostov was President of the Council of Ministers and President of the Finance and Economic-Financial Committee and in this capacity he refused to disclose to the Soviets important information about the prices of internationally traded goods. For his defending the national interest of Bulgaria in negotiations with the Soviet Union, he was severely punished despite the fact that he was one of the most prominent communists in Bulgaria (Swain and Sawin, 1993).

Conclusion

The thesis presents a comparative study of the application of bilateral clearing by two regional hegemonies – Nazi Germany and the Soviet Union in their trade relations with Bulgaria in the period 1933 – 1956. The bilateral trade regime is defined as a unique case of institutional continuity across change of regional powers and as an important part of the two international hierarchical systems, often described in the literature as imperial. From the point of view of a small trading partner – Bulgaria, the bilateral trade regime was the main method of conducting international trade from the time of the Great Depression until the collapse of the Soviet bloc, which kept its economy shielded from the competition of the world market for more than sixty years. The question why did the regime continue amidst radical changes during and after the Second World War is also approached from the small state perspective.

The analysis contrasts the two hegemonic regimes by constructing a narrative of bilateral trade relations, describing the choices, goals and limitations of policy makers in Bulgaria as well as the role local institutions and societal groups played in defining and sustaining the regime. The main thesis is that small countries had more choice than it is usually ascribed to them and that they were able not only to extract marginal economic benefits from their subordinated political positions but also to shape the rules of the international trade regime.

International hierarchy developed from a soft power position of Germany in 1933 to a hard power or economic exploitation during the war. The soft power is characterized by high level of reputation and authority of Germany as a modernizing factor for the Bulgarian economy and a partner who promised more than beneficial economic prospects; its attractiveness was based on the German efforts to assist modernization of the agrarian sector in Bulgaria and the reputation of German high culture, educational system and industrial achievements. Many of the leading Bulgarian figures in the interwar period had received their education in Germany and Austria and had good knowledge of the language and cultural codes when trading with Germans. State relations in the 1930 rested on a history of friendship, wartime camaraderie and shared revisionist claims of the Versailles Peace. But Germany was also partly blamed for the loss Bulgaria suffered during WWI and was not a model to be followed blindly. Its economic superiority was admired, its political authority was significant but also questioned and always weighted against the national interests of Bulgaria. As the time of WWII drew near, the power of Germany was more and more criticized by Bulgarian economic circles and the German plan for post-war economic organization of Europe, which assigned strictly agrarian profile to Bulgaria, was openly debated with German experts. In 1941 Bulgaria became a very reluctant ally of Germany faced with the dilemma to "eat or be eaten" (Tooze and Ivanov, 2011:49). German authority was contested around 1940 and although the state gave up certain autonomy over its foreign trade sector, it did so while strengthening its own role in a corporatist type of political economy.

The regime of bilateral trade was designed and imposed by Germany but in its adjustment to German rules and demands the Bulgarian government acted as a legitimate representative of Bulgarian interests, it consulted with the professional organizations and the Union of Exporters, financed the export to Germany and stimulated the hard currency-earning export activity. It pursued an active policy of integration with the German economy while building a strong and competent corporatist state. The analysis of the Bulgarian experience in the interwar period extends the scope of Katzenstein's analysis of "small states in world markets" by demonstrating that small states can have active economic policy under even more restricted conditions such as a regional market and bilateral clearing trade rather than the world market with global capital mobility studied by him.

Soviet hierarchy, unlike German one, started with hard power or the war-time occupation of Bulgaria and extracting in the form of reparations considerable financial and real resources from Bulgaria. Initially Bulgaria was seen as a German ally and therefore untrustworthy. In order to win the trust of the Soviets, the government had to explain its previous position *vis-à-vis* the Reich and to demonstrate full support for Stalinist-type economic development; to replace all old regime personnel and high level officials and to cut ties from the West. Soviet interference in domestic affairs exceeded any prior German influence in Bulgaria and introduced methods of terror unmatched by the previous domestic regime.

Russia was also traditionally friendly to Bulgaria, having achieved the liberation of Bulgaria from the Ottoman Empire during the Russo-Turkish war (1877 – 1878). Shared linguistic and religious heritage brought a brotherly sentiment between the two nations, which was fully exploited for propaganda purposes in the early 1950's. Such potential "soft power" was not available to the USSR in relation to the other Central and Eastern European countries. Soviet hierarchy developed from hard to softer power allowing more autonomy at the international level while controlling closely the internal sector. The Soviet Union rejected the Marshall Plan on the grounds that it was a mechanism of interfering in the domestic affairs of the small states. After excluding the East Central European countries from participating in it, the Soviet Union had to demonstrate that it was willing to treat them as equal partners. The new organization for international trade included all members at its founding meeting and their preferences, however limited within the options compatible with socialist political economy, were taken into consideration and implemented in the rules of the new institution.

While Germany used its economic attractiveness to extract economic gains from Bulgaria the Soviet Union had to offer more tangible concessions in the form of higher that world prices for East European export goods and lower than world prices for its own exports. It kept a heavy hand on the personnel and secured loyal communists in key positions, but extended economic concessions within the bilateral trade regime and increased industrial production as early as 1949.

The small state in the post war period cannot be seen as acting on behalf of societal groups or representing their interests in international negotiations. In fact actions on specific questions motivated by regard for the national interest where it diverged from the Soviet one were punished severely and demonstratively. The prior experience of bilateral clearing regime had demonstrated to the state officials the opportunities it offers – namely shielding from the competition of the global market and securing politically motivated demand for economically uncompetitive goods. The ten-year practice under German hegemony had equipped the Bulgarian delegation at the founding meeting of the CMEA with the way to organize a dyad of mutually protectionist states. This trade diversion and trade destruction also had costs – structural rigidities, lack of innovation, lack of quality improvement, which do not allow us to make a statement about the net gain or loss from the trade regime. What the thesis does aim to prove is that the continuation of the regime was possible because of the participation of the small states and that the rules they adopted were in their interest as long as their interest is understood as the interest of the official state.

It is evident that the Soviet Union was also trading with different countries in different ways and to different degrees. The continuity of the regime is obvious in the case of Yugoslavia. The Soviet Union traded with it under the same rules it traded with Bulgaria, even though Yugoslavia had more leverage against the Soviet Union and could have opted out if it so desired. Finland, a capitalist country and a member of the Organization for Economic Co-operation and Development, had an active bilateral clearing trade with the Soviet Union until its dissolution. The bilateral clearing trade brought about a corporatist type of management to Finland's export sector which was tied to the USSR – mainly wood materials and products (Laurila, 1995). At the same time, neither the Soviet Union nor the socialist republics were completely isolated from the rest of the world, and bilateral clearing trade never reached more than 70 percent of their total trade. Because of the price differential, East Central Europe was in a position to arbitrage between the two regimes and extract positive marginal gains.

This research is a contribution to the understanding of the relationship between international monetary and trade regimes and domestic political economy. Beyond the unidirectional effect of international regimes on domestic structures, I provide a dynamic explanation of how domestic structures can influence international regimes. This analysis is relevant to other cases of regional hegemonic regimes, especially in times of a weakened authority of a global hegemon. Such examples are Chinese trade in sub-Saharan Africa, which is attracting increasing attention of researchers, India and Iran, China and its East Asian neighbors and potentially all other trade regimes that operate parallel to the dominant global regime of trade in convertible currencies and capital mobility. Bilateral clearing trade has a strong distorting effect on the trade structure; it creates rigidities and removes the incentives for improving quality because markets are politically secured. It is also a strong factor for institutional convergence between hegemonic and client state.

As a single case study of political alternatives and their economic costs and benefits the thesis findings may be seen as insufficiently generalizable. However, international hierarchies operate in remarkably similar ways once we define the primary organizing principle. For the Nazi hierarchy it was economics. For the Soviet hierarchy it was politics.

Future research would be interested to compare the degree of convergence when bilateral economic ties are intensified with convergence by emulation of the legal framework, such as the process Europeanization. For scholars of the Nazi and Soviet regimes a further investigation of the motives and aims for using bilateral clearing would be a future avenue since the viewpoint presented here was that of the small state and not of the hegemonic power. For scholars of small states the thesis provides a useful case study bridging research done on small capitalist countries with research on administratively managed economies. It also has important implications for how small states are presented. As long as they are victimized and seen as lacking choice and resources, their governments are exempt from the responsibility of making political choices and being accountable for them. Persistent narratives of historical victimization form a culture of irresponsibility and the associated with it political behavior. As much as democracy relies on responsive and responsible political actors, challenging the commonly accepted understanding of the small states as victims throughout history has the potential to create not only a better understanding of the past but also a more democratic public discourse in the future.

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