

Post-war Economies (East Central Europe)

By [Wojciech Morawski](#)

Finland, Estonia, Latvia, Lithuania, and Poland – all countries founded after World War I on the ruins of the Russian Empire – had to face more complex challenges than most of the stable western states. The countries of East Central Europe needed to cope with the direct consequences of the war, to construct a stable currency system, practically from scratch, and revise their trade relations. The transportation network had to be adjusted to the delineated borders. There were also a number of grave social problems to be attended to. The capital market, seriously damaged by inflation, had to be built anew.

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Introduction

Before 1914, Finnish, Estonian, Latvian, and the majority of Polish and Lithuanian territories belonged to the [Russian Empire](#), and were strongly integrated within it. [Finland](#) and the Kingdom of [Poland](#) were relatively well industrialised, a process which had started earlier than in Russia proper.^[1] In the second half of the 19th century, both states quickly grew rich, profiting from access to the huge Russian market. Their situation changed after 1891, when the league of the three emperors was replaced by an alliance between [France](#) and Russia, beginning fast industrialisation of the Russian

hinterland. Thus, Finnish and Polish business gradually lost its position in Russia. The so called “calico war” of the 1890s between textile industries in Łódź and Moscow was one part of this process.^[2] In the Polish case, the kingdom’s proximity to Germany and Austria made its strategic position precarious.

Riga was an influential industrial centre, and, together with Liepāja, the most important Russian seaport (apart from Odessa on the Black Sea). The Estonian territories contained a fairly developed arms industry, mostly supporting the Russian Baltic Fleet. Lithuania was the least industrialised.

The Russian food market, with its plentiful and cheap products, made local production less viable in the less favourable northern climate. As a result, Finland, Estonia, and Latvia found themselves not self-sufficient in this regard after independence. Poland and Lithuania did not have this problem because of their milder climates.

After World War I, five new nation states were formed on the western fringes of the disintegrating Russian Empire: Finland, Estonia, Latvia, Lithuania, and Poland. The first three included only Russian lands, whereas the latter two also covered parts of former Germany (Lithuania and Poland) and Austria-Hungary (Poland). Moreover, Romania took over Bessarabia, which had formerly belonged to Russia. Ukraine failed to maintain its independence.

The young states faced difficult challenges. Hostilities, stretching until 1920-1921, postponed the shift of their economies to a peacetime state. Governments had to curb inflation and regain macroeconomic equilibrium. New markets were needed to replace the lost Russian one. Shifting exports from east to west often required higher quality production. Some products, which had previously been imported from Russia, now needed to be procured otherwise, often through home production. Finland, Estonia, and Latvia thus sought food self-sufficiency. Agricultural reforms were another important issue, due to their social and national meaning, and to their positive economic consequences. Moreover, the countries in question were heavily undercapitalised, having lost their ties to the Russian financial market, and suffered from post-war inflation (or, in the Polish case, hyperinflation). Finally, transportation infrastructure needed to be adjusted to the new borders.

Prolonged War and its Consequences

In the later part of World War I, all territories discussed here came under the occupation of the Central Powers. German capitulation did not lead to peace, as the Soviets gradually extended their control and tried to form dependent republics under their control. This was contested by local forces of newly forming nation states and led to a series of armed conflicts, extending beyond the Treaty of Versailles.

Estonia was the first to sign a peace treaty with Soviet Russia (Tartu, 2 February 1920). In summer 1920, as the Soviet campaign in Poland was under way, further treaties were signed by Lithuania (the treaty, signed on 12 July 1920, resulted in the Soviets ceding Vilnius to the Lithuanian state) and

Latvia (11 August 1920 in Riga). Finland signed a treaty in Tartu on 14 October 1920, gaining the Petsamo harbour and demilitarised access to the Barents Sea in return for reducing its claims in Karelia and guaranteeing Russian access to [Norway](#). Poland was the last to sign a treaty (18 March 1921 in [Riga](#)). From an economic perspective, some of the treaties stipulated Russia paying compensation for wartime evacuation: 40 million gold roubles for Poland (never paid), 15 million gold roubles for Estonia (paid), and 40 million again for Latvia. They also envisaged repatriation of populations evacuated during the war. Returning industrial facilities played a smaller role, as their assets were dispersed and decapitalised after evacuation.

Not all territorial issues were related to Russia. In 1921, Finland accepted a system of autonomy and demilitarisation of the Åland Islands. The Estonian-Latvian border was settled in Riga in an agreement from 19 October 1920, with British arbitration, which was also a factor in the Lithuanian-Latvian agreement from 20 March 1920 on the border between the two countries. The latter agreement returned Palanga – and thus sea access – to Lithuania. The Polish-Lithuanian border remained unregulated, after “revolting” Polish troops under general [Lucjan Żeligowski \(1865-1947\)](#) took Vilnius, starting a long-term conflict. The border remained closed until 1938, without even postal service between the two countries. The new borders in the region were only confirmed in 1923 by the Conference of Ambassadors, in response to the Treaty of Rapallo between Germany and Russia. Lithuania was placated with the Memel Territory after the council accepted Polish control of Vilnius.

Because of the long settling of borders, the transition to a peacetime economy and re-establishment of economic connections were postponed, along with reaching macroeconomic equilibrium and re-adjusting economies to new geo-political challenges. Between a demilitarised Germany, a weakened Russia, and a demobilised west, East Central Europe’s inevitable militarisation translated into the region’s stronger position in the 1920s, before the arms race of the following decade made it untenable.

Towards Macroeconomic Equilibrium

After the war, all countries of the region found themselves with temporary monetary systems and high inflation, which only became worse with subsequent hostilities. Regaining macroeconomic equilibrium required suppressing inflation and rebalancing budgets.

Future Polish, Lithuanian, and some Latvian lands came under the occupation of the Central Powers in 1915, which cut them off from Russia’s rouble-based monetary system, and resulted in a new system introduced by the occupying administrations. In April 1916 the *Darlehnskasse Ost* in Posen (connected with the *Ostbank für Handel und Gewerbe*) started issuing ostroubles. The official exchange rate was 100 ostroubles for 200 German marks, which differed from the pre-war rate of 100 roubles for 216 marks. Ostroubles had markings in four languages: German, Polish, Lithuanian and Latvian. In 1917, Germany decided to create a different institution for the former Kingdom of Poland. The Polish National Loan Office (PKKP) issued Polish marks, equal in value to German marks. The *Reich* committed itself to buying them back later based on the official exchange rate.

The promise was carried out after the war, but with the German hyperinflation, its consequences were symbolic. After regaining independence, Polish authorities took over PKKP and Polish marks, keeping them as a temporary measure. Late in the war, in 1917, the *Darlehnskasse Ost* was moved from Posen to Kaunas and similarly taken over by the newly formed Lithuania.

The remaining territories of Latvia, Estonia, and Finland did not suffer from the occupation currency until 1918. In Finland, Finnish marks circulated alongside roubles. Issued by the Suomen Pankki bank since 1860, the Finnish mark was equal to the franc germinal, with an exchange rate of 2.65 marks per rouble.

The Finnish mark underwent strong inflation in 1917-1922. In 1922, the government managed to achieve a budget surplus. Stabilisation policies allowed a return to gold in 1925, at 13 percent of pre-war parity (39.7 marks per dollar), albeit at the cost of a crisis in commercial banking. In 1931, Finland devalued the mark and bound itself with the sterling bloc.^[3]

The monetary situation in Estonian territories in 1918-1919 was complex, with old Russian roubles, new roubles issued by the white general [Nikolai Nikolayevich Yudenich \(1862-1933\)](#), and currency notes of the “Sons of the North” regiment denominated in Finnish marks. At first, the new Estonian state issued currency notes. Eesti Pank was created in January 1919 as a joint-stock company with a predominance of private capital. It issued Estonian marks, theoretically equal to the Finnish mark (and thus the franc germinal), but in practice depreciating fast. Attempts at stabilisation were cut short by a collapse of export to Russia in 1922. In 1923-1924 a second wave of inflation swept through Estonia. In spring 1924, Finance Minister [Otto Strandman \(1875-1941\)](#) started a stabilisation plan, based on regaining budgetary balance and limiting imports. In the same year, the mark was stabilised at 100 marks per Swedish crown. The reform was supported by a [League of Nations](#) loan of 350,000 pound sterling,^[4] and culminated in April 1927 in a redenomination based on a 100:1 ratio.^[5] The new Estonian crown was equal to the Swedish crown, with an exchange rate of 3.75 crowns per dollar. During the Great Depression Estonia first introduced exchange control in November 1931, then suspended gold convertibility in June 1933 and devalued by 41 percent, joining the sterling bloc.

In March 1919, the Latvian government started issuing currency notes denominated in roubles.^[6] During the first period of its independence, Latvia underwent high inflation. In 1921 the new lats, equal to the franc germinal, was introduced as a settlement unit. The exchange rate was stabilised at the level of fifty roubles per lats. In September 1922, Latvijas Banks came into existence, initially issuing doubly-denominated banknotes – ten latu and 500 roubles – dated 1920. Later, roubles were withdrawn from circulation, with further banknotes only denominated in lats. In 1931 Latvia introduced exchange controls, and in 1936 suspended gold convertibility, devaluing its currency by 41 percent.

Lithuania inherited the *Darlehnskasse Ost* from the German occupation, and used it as its own issuing institution until 1922, with the currency linked with the German mark. Hyperinflation in the Weimar Republic hastened Lithuania's decision to build a national monetary system. In October 1922,

Lietuvos Bankas was created as a joint-stock company, dependent upon the state. The new currency – the litas – was equal to ten American cents. In early 1923 the litas was introduced in the annexed Klaipėda Region, replacing local *Notgeld* (emergency money) denominated in marks equal to German marks. Litas was one of the most stable European currencies and Lithuanian monetary policy one of the most conservative. During the Great Depression, gold convertibility was not suspended, nor was the currency devalued, even in 1934, after the dollar devaluation. Lithuania was connected with the gold bloc until 1935, when it finally introduced exchange control.

After regaining independence, Poland kept the PKKP as its issuing authority, and the Polish mark as its currency. From the outset this was considered a temporary measure. In 1918-1923 the country underwent significant inflation, transitioning to hyperinflation in October 1923. The reason why Poland suffered from hyperinflation, like countries that had lost the war, lies in the cost of the [Polish-Soviet War](#). Attempts at stabilisation in spring 1920 had to be suspended with the war's escalation.

[Władysław Grabski's \(1874-1938\)](#) reforms from early 1924 finally managed to balance the budget.^[7] A new currency – the złoty, issued by the joint-stock Bank Polski – was introduced in 1924. It was equal to the franc germinal, with an exchange rate of 5.18 złotys per dollar. The stabilisation led to a slump, which, in 1925, caused a further collapse of the złoty, the so called “second inflation”, and a banking crisis.^[8] An economic upturn returned in 1926, and the currency was finally stabilised in 1927, after a devaluation of 41 percent. In later years the złoty remained one of the most stable European currencies. During the Great Depression, Poland belonged to the gold bloc, and with its collapse in 1936 the government introduced exchange control. While Grabski's reforms were based solely on internal resources, the 1927 stabilisation was assisted by a substantial Anglo-American loan. According to the Treaty of Versailles, the Free City of Danzig formed a common customs territory with Poland. As a result, a treaty from 1920 between Danzig and Poland stipulated a future monetary union. However, as Danzig *Notgeld* depreciated together with the German mark and thus much faster than its Polish counterpart, in autumn 1923 Danzig asked Poland to annul the treaty and agree to a separate monetary reform. The Bank von Danzig was thus created, with Poland owning a 30 percent share. It issued Danzig gulden, equal to the franc germinal. Faster stabilisation in Germany also ruined the plan to retain German currency in Upper Silesia.

Conclusion: Re-orienting the Economy

Poland, Lithuania, and parts of Latvia were already cut off from the Russian market in 1915; Finland, Estonia and the rest of Latvia only in 1918. Being cut off as early as 1915 from the Russian market resulted in the severing of traditional financial links and evacuation losses, but made adaptation easier. After the end of hostilities, old trade relations were not re-established, mostly because of autarchic tendencies in Soviet Russia. Under the New Economic Policy, Germany, rather than the USSR's direct neighbours, became their main trade partner. Estonia, which was the first to have signed a peace treaty with Russia (February 1920), proved the only exception. These contacts were profitable, with Estonia playing the role of the main Soviet connection with the west. The Estonian industry got orders placed by the Soviet authorities to sell machines, textiles, paper and cellulose. In

late 1922, after signing the Treaty of Rapallo, Russia became uninterested in pursuing relations with Estonia. Orders were revoked, and channels of international trade changed. While Russia accounted for 28.6 percent of Estonian exports in 1921, the value had fallen to 6.7 percent by 1923.^[9] This rapid severing of ties pushed Estonia into a sharp crisis in 1923-1924.

The loss of Russian markets was particularly important for the northern part of the region: Finland, Estonia and Latvia, which had to look for new buyers, found them in [Great Britain](#), [Sweden](#), and Germany. The role of Germany, small in the 1920s due to the Weimar Republic's economic issues, rose systematically in the next decade. All three northern states were not self-sufficient in terms of food production, and had to rely on international aid in the first years of independence. All three aimed at attaining self-sufficiency in a few years. Moreover, agricultural (and wood) products became major export staples. In Finland, Estonia, Latvia, and Lithuania, state support for agriculture was a major part of economic policy. Radical agricultural reforms supported intensive land cultivation.^[10] Their radicalism was influenced by the ethnic composition of large land ownership. In Finland the owners were mostly Swedes, in Estonia and Latvia Germans or Poles, and in Lithuania mostly Poles. The reforms contributed to growing land prices, accelerated capitalisation in agriculture, and strengthened internal markets by increasing the wealth of farmers. The increase of effectiveness in agriculture was for the most part based on the development of co-operative movements in production and credit.^[11] In Finland, measures were taken to use previously uncultivated land. All countries shifted production from grain cultivation to animal husbandry and dairy production; e.g. Latvia became a major exporter of butter. In Lithuania, the Dotnuva Agricultural College, founded in 1923, played a significant role in the modernisation of the sector. All four countries had strong financial institutions providing agriculture with long-term credit.

Re-orienting industrial production towards internal markets resulted in changes in industrial structure across the region. Large factories lost some ground to medium and small producers. Some new branches appeared as well, such as the fuel industry in Estonia based on bituminous slate deposits. Latvian industry found new export markets in the west, thanks to the strong position of its leading factories.

The Polish situation was different. Its dependency on Russia was smaller, both in terms of exports and imports, while the decline of the Russian market-oriented textile industry in Łódź and Białystok had already started before World War I. The destruction of assets during the war was a consequence of the Russian evacuation in 1915. The Second Polish Republic also contained former German and Austrian lands. Upper Silesia, until now an integral part of Germany, was cut in two by a border. At first, exports to Germany proceeded smoothly, but in 1925 a German-Polish tariff war broke out. Germany hoped to cause a collapse of the Polish economy, and use the opportunity to renegotiate borders. These plans did not come to fruition and Poland (in large part thanks to a major strike of British miners) was able to find new markets for Silesian coal in Scandinavia. As a result of the tariff war, Polish dependence on the German market decreased. World War I and the hyperinflation resulted in a loss of capital. After Grabski's reforms, the government hoped to attract

foreign capital. The second half of the 1920s indeed saw an influx of funds, but the Great Depression resulted in their flight. In this situation state-owned capital took their place. Companies endangered by bankruptcy were taken over by Bank Gospodarstwa Krajowego. This growing role of public capital was not a result of any particular doctrines held by the ruling elite, but was forced by the situation. The state sector notably contained a fast developing arms industry.

After the border change, the well-developed agriculture of Greater Poland (*Wielkopolska*), previously supplying Germany, now found itself part of a more difficult Polish market, with greater competition and lower prices. The sector in the Second Polish Republic was in a state of permanent overproduction crisis. At the turn of 1925 and 1926 this helped overcome the post-stabilisation slump, as high export tariffs made it possible to lower food prices and thus labour costs. In general, though, the disadvantages of this situation were greater than the potential advantages. The situation was exacerbated by a fairly conservative agricultural reform. Unlike in other countries of the region, a radical agricultural reform would negatively impact ethnic Polish landowners, and in the eastern parts of the country, Polish holdings would decrease. As a result, legislators were cautious, despite pressure from the peasantry. A lack of clear solutions to existing problems resulted in a particularly strong impact of the Great Depression on the agricultural sector.

The new border forced changes to existing transport infrastructure. Finland had to connect its northern and southern lands. Poland was forced to create connections between the Russian partition and former Austrian and German lands. Lithuania was in a particularly difficult situation, as the main transportation axis in the form of the Warsaw-Grodno-Vilnius-Daugavpils-St. Petersburg line remained on the Polish side of the border. Post-war stabilisation and reorientation of economic connections were formidable challenges for East Central European countries. Processes of accommodation became more difficult due to the crisis of the 1930s.

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Notes

1. ↑ Branch, Michael/ Hartley, Janet/Mączak, Antoni (eds.): *Finland and Poland in the Russian Empire. A Comparative Study*, London 1995.
2. ↑ Jezierski, Andrzej: *Problemy rozwoju gospodarczego ziem polskich w XIX i XX wieku [Problems of Economic Development of Polish Provinces in the 19th and 20th Centuries]*, Warsaw 1984 p. 138.
3. ↑ Kuusterä, Antti: *The Finnish Banking System in Broad Outline from the 1860s to the mid-1980s*, in: Pohl, Manfred and Freitag, Sabine (eds.): *Handbook on the History of European Banks*, 1994, p. 140.

4. † Lewandowski, Jan: Estonia. Historia państw świata w XX wieku [Estonia. History of the States of the World in the 20th Century], Warsaw 2001, p. 93.
5. † Estonian Currency Reform Law, Tallin 1927, p. 31, 35.
6. † Schur, Benjamin: Währungs- und Notenbankpolitik Lettlands, Riga 1931, p. 7.
7. † Tomaszewski, Jerzy: Stabilizacja waluty w Polsce. Z badań nad polityką gospodarczą rządu polskiego przed zamachem majowym [Stabilization of Polish Currency. Study of the Economic Policy of the Polish Government before the 1926 Coup d'Etat], Warsaw 1961, pp. 39-83.
8. † Landau, Zbigniew and Morawski, Wojciech: Polish Banking in the Inter-War Period, in: Feinstein, Charles H. (ed.): Banking, Currency and Finance in Europe between the Wars, Oxford 1995, p. 363.
9. † Lewandowski, Estonia 2001, p. 91.
10. † See Richter, Klaus: Post-war Agrarian Economic Policies (East Central Europe), in: 1914-1918-online. International Encyclopedia of the First World War, ed. by Ute Daniel, Peter Gatrell, Oliver Janz, Heather Jones, Jennifer Keene, Alan Kramer, and Bill Nasson, issued by Freie Universität Berlin, Berlin 2014-10-08. DOI: <http://dx.doi.org/10.1546333/ie1418.10464>; Roszkowski, Wojciech: Land Reforms, Warsaw 1995, pp. 223-230; Rose, Adam Karol: Reformy rolne w Europie Środkowej po wojnie światowej [Agrarian Reforms in East-Central Europe], Warsaw 1925, pp. 5-10.
11. † Kraužlis, Maciej: Ruch spółdzielczy w państwie litewskim [Co-operative Movement in Lithuanian State], Vilnius 1936.

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