Foreign Long Term Government Loans of Serbia 1862-1914

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Abstract: The paper gives an overview of foreign government loans to Serbia from 1862 to 1914. It considers the reasons for borrowing abroad and the conditions under which foreign banks placed Serbian government bonds on the European capital markets. Special attention is paid to the phenomenon of foreign government loans issued below par. Also, an analysis is made of the relationship between the stability of government finances and effective interest rates.

Key words: foreign government loans, government bonds issued below par, Serbia 1862-1914

JEL Code: H63, N13, N23

1. Introduction

Serbia took 23 long-term government loans abroad from 1878 when it was internationally recognized as an independent state at the Berlin Congress until the World War I broke out. Foreign government loans were obtained from banks domiciled in Vienna, Paris and Berlin. Those banks lent money to the Serbian government and committed to placing the Serbian long-term government bonds on the European capital markets.

Before 1914, borrowers could sell their bonds to financial public directly or indirectly, through an intermediary banker. However, for the governments of the Balkan states such choice was more theoretical than real because potential buyers of government bonds considered the intermediation of financial institutions as necessary guarantee of solvency of bond issuers.[1] At the beginning, an investor banker undertook indirect government bonds issue and later a group of banks made the banking syndicate. An investment banker or European banking syndicate would underwrite Serbian government bonds in the role of the commissioner and creditor of the Serbian state. The banks bought in advance bonds from the Serbian government and undertook the risk of selling those bonds to the public on the European stock exchanges. Such risk was implicitly built into the effective interest rates that the Serbian government had to pay on foreign long-term loans. Namely, the effective interest rates were higher than the nominal ones because government loans were generally issued below par.

The first part of this paper explains the reasons why Serbia borrowed capital abroad in the years prior to 1914. Heavy government borrowing is considered within the framework of changed political and economic conditions in the Balkans after the Berlin Congress in 1878. The second part of the paper discusses institutional arrangements for the participation of foreign representatives in the Serbian government debt management. The third part of the paper deals with the price that the Serbian government had to pay for foreign loans taken at the turn of the 20th century.

2. Reasons for borrowing abroad

Foreign long term government loans were primarily taken for financing international obligations which Serbia undertook at the Berlin Congress: to build railroads and to pay for the land owned by former Sipahis which, according to the Berlin Treaty, Serbia had gained from the Ottoman Empire. Foreign capital was also required for new military organization and armament in line with the European standards. Besides, quick development of state administrative and communal institutions urged for large financial resources. To fulfil the ever growing public needs, the Serbian state ran government budget deficits which for years were partly financed with foreign loans. Finally, Serbia was forced on several occasions to borrow money abroad to repurchase the title to the revenues from the state monopolies that were previously pledged as a guarantee for foreign debt repayments.

[1] R. P. Esteves:»Quis custodiet quem? Sovereign Debt and Bondholders' Protection Before 1914», University of Oxford Economics Series Working Papers, 2007, p. 4.

2.1. Railroad construction

The first obligation, which Serbia undertook at the Berlin Congress, was to build a network of railroads. The Serbian state became responsible for the realization of a part of the large project of Oriental Railways construction in European Turkey, which was under way at the time. In the second half of 19th century, railroad construction was a question of vital importance for the integration of national states into the world economy. For underdeveloped regions of Europe the railroads became a strategic developmental tool and for the centres of European power they were effective instruments to strengthen political and economic influence on the periphery. By the end of the 1860s, construction of railroads in Western and Central Europe was completed. Then, there was also an urgent need to start the construction of railroads on the Balkan Peninsula which in part was still under the Ottoman rule.

Within the framework of the state modernization, the Imperial Ottoman Government signed a concession agreement with Moritz von Hirsch for the construction and operation of a railway network in European Turkey, which was to connect Constantinople with Vienna. The constuction of this 1,686 km long railway lasted till 1888.[2] Until 1875, when the Oriental Railways constructiona had been temporarily interrupted, 1,150 km of railroads had been built and put in operation. After Russo-Turkish War 1877-1878, in 1878 at the Berlin Congress Serbia overtook the obligation from Ottoman Empire to build railway lines from Belgrade to Niš, with the connections to Vranje and Pirot.[3] In 1881, the Serbian government signed a Railroad Convetion with a banking house Société de l'Union Générale from Paris, ran by speculator Eugène Bontoux. This Convention consisted of an Agreement on 5% loan for railroad construction (Railways Loan A) and an Agreement on railroad construction. An engineer by profession, Bontoux worked for Austro-Hungarian railway company Südbahn from 1860 to 1877. After the defeat of the Ottoman Empire in Russo-Turkish War 1877-1878, he left Südbahn and founded Société de l'Union Générale in 1878. His intention was to quickly get rich on the Paris Burse by promoting new government bonds of the Balkan states which had undertaken the obligation to complete the construction of the Oriental Railways on their territories. At the beginning of January 1882, Société de l'Union Générale got bankrupt provoking a krach of the Paris Burse.[4] The Serbian government had to appoint another bank form Paris, Comptoir d'Escompte de Paris, to overtake the entire railroad construction business. On that occasion, this bank established Society for construction and exploitation of the Serbian state railways.

In the first decade of state independence, besides the railroad Beogad-Niš, with the connections to Vranje and Pirot built by 1884, railroads Lapovo-Kragujevac in Lepenica river valley and Velika Plana-Smederevo in Morava river valley were also constructed. Serbia took another two foreign 5% loans for the construction of these railroads (Railways Loan B and Railways Loan C) from Comptoir d'Escompte de Paris in 1885 and 1886. Those railroads were built quite quickly and less than ten years after gaining state independence Serbia had 500 kilometres of "iron road". No new railroads were built in Serbia from 1887 to 1906. During that time, Serbian government was taking abroad only the so called

[2] P. Hertner: "The Balkan Railways, International capital and Banking from the End of the 19th Century until the Outbreak of the First World War", Bulgarian National Bank Discussion Papers, DP 53, 2006, p. 7.

[3] Article XXXVIII of Berlin Treaty, July 13, 1878, Berlinski ugovor, Istorijska čitanka, Beograd, 1948.

[4] E. N. White: The Krach of 1882, the Bourse de Paris and the Importance of Microstructure, Working Paper Series, November 2006, p. 9, Available at SSRN: http://ssrn.com/abstract=948993.

unproductive loans to finance army and government budget deficits.[5] With the help of two 4,5% loans taken in 1906 and 1909 from French banking syndicate led by Franco-Ottoman Bank from Paris, the Serbian government built a pier on the Danube river, railroad from the pier on the Danube to Niš and a number of local railroads.[6] The construction of a pier on the Danube and its connection with the railway network in Serbia was of vital importance for Serbia in order to reach the world market via the Black Sea. Thanks to the railroad loans taken in 1906 and 1909, 700 km of new railroads were built, meaning that 1,200 km of railroads in total were built in Serbia until World War I.

2.2. Paying off the land of former Sipahis

The second obligation, which Serbia undertook at the Berlin Congress, was to pay off former Sipahis for the land Serbia gained from the Ottoman Empire in line with the Berlin Treaty.[7] When Serbia gained some territories in the South, its government took the obligation to respect the property rights of former landholders. Institutional property reform started in Serbia in the 1820s, while Serbia was still under the Ottoman suzerainty. Then, colonization was undertaken on the lands devastated during the Ottoman rule. With his active colonization policy, Prince Miloš Obrenović accelerated the growth of small peasant land possessions and with the interventions in the land distribution he contributed to the preservation of modest, small-scale peasant land holdings that had already prevailed during the Ottoman rule. Adhering to the rule that one could only hold the land if he tilled the soil, the colonists would be given arable lands, not only devastated ones but also those taken from former landholders who could not find time to work on them.[8] Land property had been legalized during the 1830s. Sultan's orders from 1830 and 1833 repealed all feudal obligations of the peasants towards Sipahis. This was formally acknowledged by an announcement of Prince Miloš Obrenović from 1834 and the decision of Sretenje Assembly from 1835.

During the 1830s, at times of legal regulation of private property rights, within the old state boundaries of the Principality of Serbia, peasants became free owners of the land they worked on and all Sipahi claims were included in vassal tribute paid to Supreme Porte.[9] However, after the Berlin Congress, in the newly independent Serbia, peasants were burdened with Sipahi clams and they were obliged to pay off the ransom in land within five years.[10] Since the peasants could not meet their obligations on time, economic position of old landholders continuously worsened. To prevent their

[5] In classic theory of public finance, there was a negative attitude towards government loans, especially towards so-called unproductive loans, such as war loans that made warring powers accumulate large government deficits. See for example P. Leroa Bolije: O javnom kreditu /Državnim dugovima, Državna štamparija Kraljevine Srbije, Beograd, 1905.

[6] Loans form 1906 and 1909 were aimed for the railroad construction and for the army modernization. For railroad construction, 35 million dinars (Fr. francs) was used out of 81 million dinars (Fr. francs) effectively obtained from 1906 loan and 56 million dinars (Fr. francs) out of 110 million dinars (Fr. francs) effectively obtained from 1909 loan. The rest of effectively obtained money from those two loans was used for the army modernization. D. Gnjatović: Stari državni dugovi, Prilog ekonomskoj i političkoj istoriji Srbije i Jugoslavije, Jugoslovenski pregled, Beograd, 1991, pp. 92-93.

[7] Article XXXIX of Berlin Treaty.

[8] Ž. Đorđević: "Mali seljački posed kao ograničenje ekonomskog razvoja Srbije u XIX veku", Ekonomska misao, br. 3, 1989, pp 336-359.

[9] D. Gnjatović: Ekonomija Srbije - Privredni sistem, struktura i rast naconalne ekonomije, Megatrend univerzitet, Beograd, 2007, p. 54.

[10] "Zakon o agrarnim odnošajima u novooslobođenim predelima od 3. februara 1880", Zbirka zakona i pogodaba Kneževine Srbije, Beograd, 1880.

complete ruin, Serbian government took over the peasants' debts. The State secured its creditor position by putting mortgage on peasants land properties. Thus peasants, new landowners, became mortgage debtors of the State. To meet new financial obligations, Serbian government took 5% ***Agrarian Loan*** from *Comptoir d'Escompte de Paris* and Viennese *Länderbank* in 1882.

2.3. War and armament loans

Serbia took war loans abroad even before it was internationally recognized as an independent sate. Its government tried to take a foreign loan while Serbia was still the vassal of the Ottoman Empire. Under Ottoman suzerainty, Serbia was not a subject of international law so it could not borrow publicly abroad. Yet, its internal autonomy gave her the right to borrow at home.[11] After several unsuccessful attempts to collect enough money at home for the financing of war preparations, Serbian government appealed to Russia without any knowledge of Sublime Porte. With the guarantee of the Russian Emperor, The Principality of Serbia took war loans from investment banks from London in 1862 and 1867 and from Petersburg in 1876. The loans were issued at par because there was a state guarantee both on the side of the debtor and on the side of the creditor - Serbia and Russia. The first foreign loan was repaid only in 1862. When Serbia became internationally recognized as an independent state at the Berlin Congress in 1878, it was revealed that it had entered the European community of states with 7.4 million dinars (Fr. francs) of foreign debt.[12]

Until World War I, The Kingdom of Serbia financed military reforms with the help of foreign loans on three occasions. One of the first institutional reforms undertaken by the independent state was the constitution of regular military forces and introduction of a compulsory military service. To accomplish this goal, the Serbian government took a 5% armament loan from the Anglo-Austrian Bank from Vienna in 1882. Also, in order to modernize the armament, the Serbian government used some of the money from two 4,5% loans taken from the Syndicate of French banks in 1906 and 1909 (Railroad Construction and Army Modernization Loan I, Railroad Construction and Army Modernization Loan II,).[13]

Before World War I, The Kingdom of Serbia took war loans on two occasions. The first 5% war loan obtained from Comptoir d'Escompte de Paris in 1885 was linked to an inglorious episode when Serbia started war against Bulgaria. Namely, when Bulgaria annexed Eastern Rumelia, King Milan Obrenović considered that the balance between Balkan states established by the Berlin Treaty had been disturbed.[14] After the defeat of the Serbian army, thanks to the intervention of the Austro-Hungarian empire, the territorial status quo was restored to that existing before the war. The second 5% loan was taken in 1913 to cover the expenses of the Balkan wars 1912-1913. The Serbian government financed the Balkan wars from its own revenue sources and with the help of short term borrowing from the state and private banks at home. The expenses of Balkan wars were recorded in a separate government

[11] For the conduct of war, 24 million dinars (Fr. francs) were needed, but Serbian government collected only 1.7 million dinars (Fr. Francs) with help of two internal loans. D. Gnjatović: Stari državni dugovi, Prilog ekonomskoj i političkoj istoriji Srbije i Jugoslavije, p. 21.

[12] V. Jovanović: "Era stranih zajmova u Srbiji", Arhiv za pravne i društvene nauke, Beograd, 1906, str. 196.

[13] For armament modernization, 46 millions dinars (FR. francs) were effectively used from 1906 loan and 54 millions dinars (FR. francs) were effectively used from 1909 loan.

[14] S. Jovanović: Vlada Milana Obrenovića, Knjiga II, Geca Kon, Beograd, 1934, p. 55.

budgets.[15] After the demobilization of the Serbian army at the end of August 1913, the Serbian government took a 5% loan from the Syndicate of French banks led by Franco-Serbian Bank to cover the expenses of the Balkan wars (Loan for Balkan Wars).

2.4. Financing government budget deficits

The State Treasury of Serbia was permanently in deficit from the time of the liberation wars 1876-1878 until 1903 (Table 1). Government revenues in budget proposals for each fiscal year until 1902 were planned without any realistic prior assessments. So, during the fiscal year, the government would think of ways to make up for the allegedly unplanned shortages. In those times, a crucial problem of the Serbian state finances was a backward tax system that depended heavily on personal tax revenues. With the help of a reform of the tax system, various sorts of taxes were introduced in line with the comparative practices of other European states.[16] Thanks to the strengthening of economic and tax power of the state and the tax reform, with Dr Laza Paču as finance minister since 1902, the Serbian government started pursuing the policy of realistic state finances. In the government budget proposal for the fiscal year of 1903, the budget deficit was planned, and that was the last year in a raw which Serbia ended with a budget deficit. From 1904 until the World War I broke out, the final accounts of government revenues and expenditures of the Kingdom of Serbia were always in surplus.

The policy of fictitious, unrealistic budgeting that had been practiced until 1902 could be pursued at a large extent thanks to borrowing abroad to finance government budget deficits. Serbia took foreign long-term loans to cover government budget deficits on eight occasions: 3% lottery loan (1881) and seven 5% loans (1884, 1886, 1888, 1893, 1893, 1899, 1902).

The Serbian government issued the 3% Lottery Loan in 1881 under the persuasion of Eugène Bontoux because he was in an urgent need of money to begin the railroad construction works. Bontoux looked upon the unique practice of the 3% lottery loan of the Ottoman state from the 1870s. In those days, the issue of lottery bonds was questionable so they were not officially quoted on the European capital markets. The exception was made in 1870 when the bonds of the 3% Ottoman lottery loan called Türkenlose appeared on the Vienna stock exchange. The creation of those bonds was attributed to Moritz von Hirsch who needed money to begin the construction works of Oriental Railways in Europe. These lottery bonds bore low interest but were redeemable every two or six months at a high redemption price. They were very popular with smaller European investors especially in France and Germany. However, ordinary citizens of the European states considered those lottery bonds to be a part of an organized theft because Hirsch decided that even those lottery bonds, which were not sold, should participate in drawings every six months. In such circumstances, the chances to earn even a small prize were very weak for all but large investors including Hirsch himself.[17] The Serbian 3% lottery loan was originally aimed for the financing of budget deficits in general, but one third of those bonds served to collect money to begin the railroad construction works. Without his own capital, Bontoux could not wait for the government bonds of 5% Railroad loan from 1881 to be sold. He calculated that 3% lottery bonds would be sold more quickly thanks to their high prize, and that was exactly what happened.

[15] Završni račun državnih prihoda i rashoda Kraljevine Srbije za 1913. godinu,Beograd, 1922, p. X.

[16] Republički zavod za statistiku: Dva veka razvoja Srbije, Beograd, 2008, pp. 91-95.

[17] P. Hertner, op. cit, p. 9-11.

Seven 5% loans for government budget deficit financing were very unpopular in Serbia because Serbian government pledged all rich sources of its revenues to guarantee their repayments. It was very difficult to explain to the public why the revenue sources were to be pledged in order to get loans for unproductive purposes. Serbia was forced to pledge government revenue sources since it took first loans abroad for the financing of railroad construction works, but the productive purpose of spending borrowed capital justified the guarantees asked from foreign borrowers (Table 2). In order to obtain loans for railroad construction works, Serbia pledged its customs duties revenues, personal tax revenues, and future revenues from the exploitation of railroads, and issued bonds secured by a mortgage on the railroads. The Serbian government guaranteed payment of 7,800 dinars (Fr. francs) from the railroad's revenue to *Comptoir d'Escompte de Paris f*or every kilometre of the railroad built. To take war and armament loans, the Serbian government pledged the revenues from the state monopolies on imports of salt and tobacco. To finance government budget deficits with foreign loans, Serbian government pledged the administrative duties revenues, turnover tax revenues, revenues from 16% extra duty for military needs, as well as mortgage bonds issued by the state mortgage bank *Uprava fondova.*

People in Serbia named each unproductive loan by the source of revenue that was pledged as a guarantee for its repayment. The Ministry of Finances accepted such practice and recorded various government debts under those names.[18] The armament loan taken from the Viennese Anglo-Austrian Bank in 1882 was named Salt Loan from 1882 because the revenues from the state monopoly on imports of salt were pledged to guarantee its regular payment obligations. A loan for the war against Bulgaria taken from Comptoir d'Escompte de Paris in 1885 was named Tobacco Rent because the revenues from the state monopoly on imports of tobacco were pledged as a guarantee for its repayments. Loan called Administrative Duties Rent obtained from Comptoir d'Escompte de Paris and Viennese Länderbank in 1884 for the financing of state budget deficits was secured with the revenues from different administrative duties. Similar practice was then used for all other loans taken for the financing of government budget deficits. Namely, in 1886 Serbian government pledged mortgage bonds issued by Uprava fondova to get the so called Funds Loan. The revenues from turnover tax insured loan called Turnover Rent taken from Comptoir d'Escompte De Paris, Viennese Länderbank and Berlin Merchant Company in 1888. The so called Loan on 16% Additional Tax obtained from Viennese Länderbank, Berlin Merchant Company and Ottoman Bank from Paris in 1893, was secured with the revenues of 16% additional tax which was introduced in 1892 in order to fill the partially empty state treasury. In 1893, another loan had been obtained from the three mentioned banks and it wan named Loan on the Account of Railways Directorate because its repayment was guaranteed with the revenues of Railway Directorate. To secure so called Exploitation Loan taken from Viennese Union Bank in 1899 Serbian government pledged the revenues from railways exploitation and to secure so called Monopoly Loan taken from French banking syndicate in 1902, Serbian Government pledged the surpluses of revenues of Independent Monopoly Directorate.[19]

[18] Budžet Kraljevine Srbije za 1894, Beograd, 1894; Budžet Kraljevine Srbije za 1903, Beograd, 1903.

[19] D. Gnjatović: Stari državni dugovi, Prilog ekonomskoj i političkoj istoriji Srbije i Jugoslavije, pp. 26-96.

2.5. Foreign loans of Uprava Fondova

The state mortgage bank Uprava fondova, established in 1868, took 4.5% loans abroad in 1910 and 1911 because it did not have sufficient capital to finance infrastructure investments in Serbia. In order to get these loans, Uprava fondova issued its own mortgage bonds. Mortgage loans that were previously approved by Uprava fondova to the public and private persons in Serbia served as a guarantee for those mortgage bonds. The creditors were French Bank for Trade and Industry and Franco-Serbian Bank. The money from the first Loan of Uprava Fondova was spent for the communal works in smaller cities in inland Serbia. The second Communal Loan of Uprava Fondova was primarily aimed for the construction of communal infrastructure in Belgrade. After the Balkan Wars, Uprava Fondova planned to take another 5% loan from a syndicate of banks from Paris led by Franco-Serbian Bank. The issue of that loan was planned for 1914. Uprava fondova took an advance payment from Franco-Serbian Bank but due to economic and political circumstances on the eve of World War I, that loan was never issued.[20]

3. Foreign debt management

There were special institutions established in The Kingdom of Serbia for foreign debt management. At first, those were the so called particular treasuries of foreign government loans. After the state bankruptcy in 1893, those particular treasuries ceased their operations and were replaced by the Independent Monopoly Directorate.

3.1. Particular treasuries of foreign government loans

In order to secure regular repayments of foreign debts of Serbia, foreign banks initiated the establishment of a particular treasury for each loan (Annex Table 3). In case the inflow of pledged revenue was larger than the annuity of a particular loan, the surplus revenue was channelled into the government budget. In case of the pledged revenue shortages, the State met its financial obligations towards creditors from other government revenue sources. Each particular treasury was under control of the Serbian government representative and foreign bank representative that was a commissioner and creditor of the Serbian state. This formal, and at the same time informal institution was established for the first time already at the occasion of signing of the first Railroad Loan in 1881. Thus, partial supervision over the state finances of independent Serbia started with its first foreign loan. Until the state bankruptcy in 1893, six particular treasuries of foreign loans operated in Serbia. Particular Treasury of Serbian State Railways supervised the repayments of Railroad Loans (1881, 1885, 1886) and Lottery Loan (1881). Other particular treasuries: Treasury for Agrarian Loan (1882), Treasury for Administrative Duties Rent (1884), Treasury for Tobacco Monopoly (1885), Particular Treasury for 5% Mortgage Bonds of Uprava Fondova (1886) and Particular Treasury for Turnover Tax (1888) supervised the inflow and outflow of financial sources of each of the above foreign loans.

[20] One Hundered and Twenty Years of Investbank, Investbanka, Beograd, 1987 [In Serbian].

3.2. Repurchase of state monopolies

Free from budget control, particular treasuries of government loans were fertile soil for various abuses. Especially large abuses were made with the revenues from the state monopolies. The revenues from state monopolies were farmed out to the same foreign banks that were the creditors of the Serbian state. Thus, a creditor was at the same time a leaseholder of the very revenue that served for the repayment of the loan.

Particular Treasury for Tobacco Monopoly was governed by Comptoir d'Escompt de Paris and Viennese Länderbank, which approved 5% Tobacco Loan to the Serbian Government in 1885. Those banks founded Society for Tobacco Monopoly Lease and they were in a position to monitor and directly control payment of annuities. Making false statements, they diminished real tobacco monopoly revenue surpluses after annuity payments. They did not even hesitate to present an alleged revenue shortage. Such shortages reached 1.5 million dinars (Fr. Francs) in 1887 and the Serbian Government was forced to cover them from other revenue sources. In a need to stop such financial abuses, Serbian Government broke Tobacco Monopoly Lease Agreement in 1888. To be able to pay out Society for Tobacco Monopoly Lease, Serbia took 5% Lottery Loan from Viener Bankverein. The extent to which the Serbian government revenues were impaired by such behaviour of foreign banks could be illustrated by the fact that in the first year after it was repurchased, net revenues from the tobacco monopoly exceeded two millions dinars (Fr. Francs).[21]

After repurchasing tobacco monopoly, the Serbian Government decided to overtake the exploitation of railways. The immediate cause for this operation was the bankruptcy of Comptoir d'Escompt de Paris. After the crash of Société de l'Union Générale, this bank held the destiny of the Serbian Railroads in its hands. Revenues from the exploitation of the railways were regularly lower than those guaranteed by the Serbian Government. In 1882-1889, the deficit reached 2.5 million dinars (Fr. Francs) and the State had to make it up to Comptoir d'Escompt de Paris from other government revenue sources. To be able to repurchase the right to exploitation of the railways, the Serbian Government took a 5% loan from the Syndicate of French banks in 1890. Privileged National Bank of The Kingdom of Serbia also took part in this financial operation. Since it was aimed for the repurchase of the exploitation of railways, this loan was named Railways Rent.

Immediately after taking over the exploitation of railways, it was time to repurchase the salt monopoly from the Anglo-Austrian Bank. Revenues from the state monopoly on salt imports were pledged in 1882 as a guarantee for an armament loan. The salt monopoly had been farmed out to Anglo-Austrian Bank for 15 years, the period exactly matching the maturity of the 5% armament loan. The immediate cause for breaking up the agreement with this Viennese bank was the revelation of illegal operations of the Society for Salt Monopoly Lease. The public was informed that this Society did not sell pure salt but mixed with soil and stone, that it charged for salt twice its real price, that it made false statements of its revenues and expenditures.[22] To buy back the salt monopoly, the Serbian Government took a 6% loan from the syndicate of French banks in 1890. The Privileged National Bank of The Kingdom of Serbia participated again in this operation. Since this loan was intended for buying back of the salt monopoly it was named Salt Loan from 1890.

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[21] M. Nedeljković: Istorija srpskih državnih dugova, Štampa, Beograd, 1909, p. 153.

[22] Odjek, no 192, November 1890.

3.3. Independent Monopoly Directorate

In 1894, Vukašin Petrović, new minister of finance declared that Serbia was not able to continue with regular foreign debt repayments under the originally contracted terms and conditions. Foreign debt repayments that were due in 1893 reached 37.2% of the overall government budget revenues (Table 1).[23] It was an example of open government bankruptcy, similar to those of the Ottoman Empire in 1876 and Greece in 1893. Before 1914, open government bankruptcies occurred in states on the gold standard that accumulated large government budget deficits. In the conditions of fixed exchange rates, it was not possible to alleviate the debt burden by inflating it, what would be a characteristic of hidden state bankruptcies.[24] To alleviate debt burden, the Serbian government asked foreign creditors for debt conversion. Preliminary agreement on debt conversion was made with Ottoman Bank from Paris, Berlin Trade Company and Viennese Länderbank in December 1894. It was negotiated that outstanding debt from ten 5% loans: Railway Loans (1881, 1885, 1886), Agrarian Loan (1882), Administrative Duties Loan (1884), Tobacco Rent (1885), Turnover Tax Rent (1888), Railways Rent (1890), Loan on 16% Additional Tax (1893) and Loan on the Account of Railways Directorate (1893) would be unified and converted in one 4% loan and that the 3% Lottery Loan from 1881 would be converted into a 2% Loan. The Agreement on debt conversion authorizing the Serbian government to issue new 4% Conversion Loan was signed with three of the above creditor banks in Carlsbad (Karlove Vari) in June 1895.

Many creditors stood against Carlsbad Agreement because they were forced to accept the reduction of interest rates on 5% Serbian government bonds as fait accompli. Three banks that participated in Carlsbad arrangement held only one seventh of 5% bonds of the Serbian government loans, which were converted.[25] For all other creditors of Serbia, Carlsbad arrangement meant compulsory settlement because the bond holders of ten 5% loans were obliged to exchange them for 4% bonds in six weeks at the latest.[26] The fact that the Paris Burse was closed for the Serbian government bonds over the next seven years speaks for itself about the extent to which most of French bankers were provoked.

To secure regular debt repayment of the 4% Conversion Loan, the Law on debt conversion stipulated that all government revenues previously pledged should be pledged again in addition to some new ones as well as some others (Annex Table 2). Independent Monopoly Directorate was assigned to manage all pledged revenues as well as those revenues from the state monopolies that had not been previously pledged. The Managing Board of the Independent Monopoly Directorate had six members. Four members were the representatives of the Serbian government and among them were the governor and vice governor of the Privileged National Bank of the Kingdom of Serbia, while two members were the representatives of creditors. The Managing Board was authorized to independently manage government revenues that ended up in the Independent Monopoly Directorate. Its obligation was to

[23] The idea of foreign debts conversion was originally exposed in Parliament by Mihailo Vujić, Ministry of Finances in 1887. He searched for the ways to cut government expenditures because in fiscal 1886, 30% of government expenditures were covered by deficit financing.

[24] P. Bernholz: "Government bankruptcy of Balkan nations and their consequences for money and inflation before 1914: A comparative analysis", Bank of Greece Working Paper, SEEMHN, no. 74, 2008, str. 23; M. Šojić, Lj. Đurđrvić: «Dinar Exchange Rate in the Kingdom of Serbia 1882-1914», The Experience of Exchange Rate Regimesun Southeastern Europe in a Historical and Comparative Perspective, ONB Workshop no 13, 2007, pp. 303-329.

[25] M. Nedeljković: Istorija srpskih državni dugova, p. 179.

[26] Zakon o konverziji državnih dugova 8. juli 1895, Beograd, 1895.

deliver government revenue surpluses to the central government treasury every month once one twelfth of the annuities of the 4% Conversion loan were met.

The centralization of the government debt management in the Independent Monopoly Directorate proved to be a step towards putting the Serbian state finances in order. It was a solid formal, and at the same time, an informal institution that took care not only of the regular debt repayments of the 4% Conversion Loan but also of the regular payments of revenue surpluses from the state monopolies into the central government treasury. Since net revenues of Independent Monopoly Directorate grew more quickly than the annuities of the 4% Conversion Loan, revenue surpluses aimed for the central government treasury also grew constantly.

Table 1

Disposition of Net Revenues of Independent Monopoly Directorate

Year	Net revenues of Independent Monopoly Directorate (in millions of dinars)	Annuities of 4% Conversion Loan (in millions of dinars)	Annuities as % of net revenues	Revenue surpluses delivered to State Treasury (in millions of dinars)
1896	20.0	16.7	83.5	3.3
1900	25.9	17.4	67.2	8.5
1905	32.9	20.2	61.4	12.7
1906	34.7	20.3	58.5	14.4
1907	38.2	23.4	61.2	14.8
1908	37.4	25.1	67.1	12.3
1909	36.9	25.9	67.7	11.9
1910	41.3	30.8	74.6	10.5
1911	48.1	32.4	67.3	15.7

Source: Završni račun državnih prihoda i rashoda 1911, Državna štamparija, Beograd, 1912.

France decided to reopen its door to the Serbian government bonds in May 1902. On that occasion the Serbian government agreed to have the representative of the French government on the Managing board of the Independent Monopoly Directorate in place of one other representative of foreign creditors.

4. The price of foreign government loans

From 1881 to 1913, Serbia issued guarantees for the repayment of 1,354 million dinars (Fr. francs) of the principal of 23 foreign loans. However, Serbian Government received effectively only 1,113 millions dinars (Fr. francs) because all foreign government loans, except two, were issued below par.

Issuing government loans at par meant that the borrowing state would receive from the buyers of government bonds the nominal amount of money shown on those bonds. At the time of debt settlement, neither the borrowing state nor the creditors would either lose or earn anything else but the nominally agreed interest. In such conditions, the effective interest rate would be the same as the nominal interest rate. Hence, interest rate paid by the borrowing state on loans issued at par would depend on the current market rate and loan maturity. The only two foreign government loans of Serbia issued at par were the so called Salt Loans from 18882 and 1890. For the repayment of those two loans the Serbian government gave all possible guarantees, so the banking risk was reduced to the minimum. Namely, the Serbian government committed to a relatively short repayment period, 15 and 10 years respectively, while other loans were repayable in 50 years on average. Besides, loan maturity of the Salt Loan from 1882, which was aimed for military purposes, was tied to the lease period of the salt monopoly granted to the creditor, Anglo-Austrian Bank. Finally, Salt Loan from 1890, taken to buy back the salt monopoly, besides short maturity period bore a relatively high 6% interest, while all earlier loans, except the 3% Lottery Loan from 1881, bore interest of 5%.

Since the 1870s, in critical moments, in Europe, issuing government loans below par had almost become a rule because that was the only way to get larger sums of money.[27] The State would take responsibility towards the creditor for larger principal than the effectively received sum of money. The practice of issuing loans below par was especially widespread in countries of low or unknown creditworthiness. Such practice was regularly repeated in the Balkan states at the end of the 18th century and at the beginning of the 19th century.[28] The fact that from 1881 to 1913 Serbian government borrowed nominally 1,354 millions dinars (FR. Francs) and received effectively 1,113 millions dinars (Fr. Francs) means that the price of foreign loans taken by the Kingdom of Serbia was de facto 18% higher than nominally agreed.

When negotiating a loan with the Serbian government foreign banks were guided by the price at which they hoped to sell Serbian government bonds on the European capital markets. Their profit depended directly on the accuracy of their estimates. Before debt conversion in 1895, 5% Serbian government bonds sold at 65 to 72 on the stock exchanges in Vienna and Paris.[29] Such relatively poor creditworthiness of Serbia was primarily a consequence of the financial instability provoked by the accumulation of government budget deficits. The prices of Serbian government bonds started to rise only after foreign debt repayments were centralized within the Independent Monopoly Directorate. Moreover, the introduction of the policy of realistic budgeting in 1902 and running budget surpluses from 1904 onwards had a favourable effect on the price of the Serbian government bonds. Beginning from 1904, the discount rate on the Serbian government bonds was constantly falling so the bonds sold at 90 in 1911. Before World War I, the only Serbian government bonds sold on the European stock exchanges at prices above par were 5% Lottery Bonds from 1888. The fact that they sold abroad at 130 was irritating to the local public in Serbia because the Lottery Loan from 1888 was considered the worst ever made by the Serbian government for it was issued at a 50% discount from par.[30]

[27] In the history of public finance it is said that the first loan was issued below par by Great Britain in the 1780s. In search for large sum of money Great Britain accepted to receive less than nominally said on the issued bonds, on condition it pays a somewhat lower interest rate. R. Harris."Government and the Economy, 1688 - 1850", R. Floud and P. Johnson Eds. The Cambridge Economic History of Britain since 1700, Volume I, 1700 - 1850 , Cambridge University Press, 2004, pp. 204-237.

[28] P. Bernholz: "Government bankruptcy of Balkan nations and their consequences for money and inflation before 1914: A comparative analysis", p. 23.

[29] Trgovinski glasnik, 8. 12. 1901.

[30] M. Nedeljković, Istorija srpskih državnih dugova, p. 99.

Table 2

Nominal and effective interest rates on the Serbian foreign long-term government loans issued below par 1881-1912

	Nominal amount borrowed	Effective amount received	Nominal interest rate	Effective interest rate
Period of budget deficits 1881-1903.	398,936,500	308,198,300	5%	6.47%
Period of stability 1904-1912.	305,000	240,800	4.5%	5.70%

Source: As for Annex Table 3.

The strengthening of Serbia's creditworthiness can be observed during two distinctive periods, by comparing the average effective prices of loans made in 1881-1903 and 1904-1912 (Table 2). The loan repayment period did not change in the two periods, since the majority of external borrowing were 50 year loans. On the other hand, the nominal interest rate fell from 5% to 4,5% in the two respective periods as well. Besides, the average discount rate on the Serbian government loans issued below par fell from 22,75% to 21,05% during those two periods. Lower nominal interest rate and lower discount rate on loans issued below par positively affected the level of the effective interest rate. While in 1881-1903, at times of financial instability provoked by the accumulation of budget deficits, the average effective interest rate on foreign loans issued below par was 6.47%, in 1904-1912 period of stable state finances this rate fall to 5.70%.

5. Conclusion

Large undertakings in Serbia at the turn of the 20th century resulted in a quick growth of government expenditures. War financing, army modernization, railroad construction and foreign debt repayments soaked more money than Serbia was able to collect in taxes. Hence, government budget deficits became inevitable. However, until 1903, budget deficits were not planned, but were the outcome of ad hoc decisions of the government running short of financial resources. This policy of fictitious, unrealistic budgeting had a negative impact on the creditworthiness of Serbia and on the price of the Serbian government bonds on the European stock exchanges. To obtain foreign loans, Serbian government pledged all of its abundant sources of revenues. Many of them were farmed out to the very same foreign banks that were creditors of Serbia. Under the threat of losing its fiscal sovereignty, the Serbian government took new foreign loans to repurchase the leased government revenues. After the Serbian government declared open state bankruptcy in 1893, the Independent Monopoly Directorate was established to centralize the management of foreign debt repayments. Institutionalization of foreign debt management proved to be a viable solution. The Independent Monopoly Directorate constantly ran net revenue surpluses that filled the government treasury. After fiscal 1903, the last in a string of years ending with a government budget deficit, creditworthiness of Serbia started to improve. From 1904 until World War I, new Serbian foreign government loans were still issued below par, but under more favourable conditions. The policy of realistic budgeting paved the way for the creation of sound government finances.

Annex tables

Annex Table 1

Government revenues and expenditures of Serbia 1880-1912, in dinars (F. francs)

Year	Government revenues	Government expenditures	Surplus/Deficit
1880	19,145,376	19,520,477	-375,100
1881	25,682,514	25,714,543	- 32,029
1882	25,688,326	32,611,191	-6,922,865
1883	28,314,973	34,469,918	-6,154,981
1884	32,641,645	37,291,159	-4,649,514
1885	38,746,135	45,968,639	-7,222,504
1886	32,168,687	46,000,000	-13,832,313
1887	38,229,055	44,460,000	-6,230,945
1888	37,625,516	44,635,492	-7,000,976
1889	36,863,730	51,869,999	-14,333,134
1890	41,970,794	46,196,864	-4,226,115
1891	56,840,331	57,527,084	-686,753
1892	51,868,393	60,110,595	-8,242,202
1893	55,652,597	62,719,846	-7,067,249
1894	57,786,222	62,623,868	-4,837,646
1895	58,457,985	66,603,341	-8,145,356
1896	59,633,192	66,026,587	-6,393,395
1897	61,646,870	72,125,298	-10,478,428
1898	65,840,209	80,687,519	-14,847,310
1899	72,095,997	85,476,976	-13,380,979
1900	75,306,229	84,419,516	-9,113,287
1901	79,698,000	92,089,000	-2,491,000
1902	78,638,000	99,414,000	-20,776,000
1903	92,025,000	109,333,000	-17,307,000
1904	110,238,000	92,062,000	+18,176,000
1905	91,817,000	87,676,000	+4,141,000
1906	91,270,374	87,335,641	+3,934,733
1907	94,824,117	86,689,935	+8,134,164
1908	95,293,792	93,877,335	+1,416,457
1909	105,130,472	103,682,453	+1,448,017
1910	116,581,133	111,633,528	+4,947,605
1911	131,280,133	114,733,528	+16,546,605
1912	125,200,000	120,900,000	+4,300

Source: Završni račun državnih prihoda i rashoda, Državma štamparija Klaljevine Srbije, Beogad, various years.

Annex Table 2

Foreign Long Term Government Loans of Serbia 1881-1913

Loan	Nominal amount, in dinars (Fr. francs)	Discount rate	Effective amount, in dinars (Fr. francs)	Nominal interest rate	Effective interest rate	Repayment period
Railways Loan A (1881)	100,000,000	28.6%	71,400,000	5.0%	7.0%	50 yeas
3% Lottery Loan (1881)	33,000,000	25.5%	24,585,000	3.0%	4.0%	50 years
Salt Loan (1882) for armament modernization	5,600,000	0%	5,600,000	5.0%	5.0%	15 years
Agrarian Loan (1882)	6,000,000	28.6%	4,284,000	5.0%	7.0%	25 years
Administrative duties Rent (1884) for government budget deficit financing	40,270,000	41.0%	23,759,300	5.0%	8.5%	70 years
Tobacco Rent (1885) for Serb - Bulgarian War	40,000,000	41.0%	23,600,000	5.0%	8.5%	49 years
Railways Loan B (1885)	3,.000,000	27.5%	21,750,000	5.0%	6.9%	50 years
Railways Loan C (1886)	12,500,000	28.6%	8,925,000	5.0%	7.0%	50 years
Funds Loan (1886) for government budget deficit financing	12,000,000	70.0%	3,600,000	5.0%	16.7%	37.5 years
Turnover Tax Rent (1888) for government budget deficit financing	24,000,000	20.0%	19,200,000	5.0%	7.5%	50 years
5% Lottery Loan (1888) for repurchase of revenues from tobacco monopoly	10,000,000	50.0%	5,000,000	5.0%	10.0%	65 years
Railways Rent (1890) for Repurchase of Railways	26,666,500	25.0%	20,000,000	5.0%	6.7%	60 years

Salt loan from (1890) for repurchase of revenues from salt monopoly	6,000,000	0%	6,000.000	6.0%	6.0%	10 years
Loan on 16% additional tax (1893) fro government budget deficit financing	18,000,000	24.0%	13,680,000	5.0%	6.6%	50 years
Loan on account of Railway Directorate (1893) for government budget deficit financing	8,000,000	37.5%	5,000,000	5.0%	8.0%	50 years
Conversion Loan (1895)	355,292,000	12.6%	310,543,775	4.0%	4.6%	72 years
Exploitation Loan (1899) for government budget deficit financing	11,500,000	13.1%	10,000,000	5.0%	5.7%	15 years
Monopoly Loan (1902) for government budget deficit financing	60,000,000	20,0%	48,000,000	5.0%	6.25%	50 years
Railroad construction and army modernization I (1906)	95,000,000	15.0%	80,750,000	4.5%	5.3%	50 years
Railroad construction and army modernization II (1909)	150,000,000	16.9%	109,950,000	4.5%	6.1%	50 years
Loan of Upr. fondova (1910)	30,000,000	17.0%	24.900,000	4,5%	5.4%	50 years
Communal Loan of Upr. fondova (1911)	30,000,000	16.0%	25,200.000	4.5%	5.4%	50 years
Loan for Balkan Wars (1913)	250,000,000	15.3%	211,875,000	5.0%	5.9%	50 years

Annex Table 3

Guarantees for Foreign Debt Repayments and Foreign Debt Management in Serbia 1881-1913

Loan	Pledged Revenues	Institution for Foreign Debt Management	Creditor Banks
Railways Loan A (1881)	Import duties, personal tax, future revenues from railways, mortgage on railways	Particular treasury of Serbian Railways	Länderbank, Vienna
3% Lottery Loan (1881)	Import duties, personal tax, future revenues from railways, mortgage on railways	Particular treasury of Serbian Railways	Länderbank, Vienna
Salt Loan (1882) for armament modernization	State monopoly on imports of salt	State treasury	Anglo-Austrian Bank, Vienna
Agrarian Loan (1812)	Mortgage on lands of former Ispahis	Particular treasury of Agrarian Loan	Comptoir d'Escompte, Paris Länderbank, Viena
Administrative duties Rent (1884) for government budget deficit financing	Administrative duties	Particular treasury of Administrative Duties Rent	Comptoir d'Escompte, Paris Länderbank, Vienna
Tobacco Rent (1885) for Serb - Bulgarian War	State monopoly on imports of tobacco	Particular treasry of Tobacco Rent	Comptoir d'Escompte, P Länderbank, Vienna
Railways Loan B (1885)	Import duties, personal tax, future revenues from railways, mortgage on railways	Particular treasury of Serbian Railways	Comptoir d'Escompte, Paris
Railways Loan C (1886)	Import duties, personal tax, future revenues from railways, mortgage on railways	Particular treasury of Serbian Railways	Comptoir d'Escompte, Paris
Funds Loan (1886) for government budget deficit financing	Mortgage bonds of Uprava fondova	Particular treasury for Funds Loan	Berlin Merchant Society
Turnover Tax Rent (1888) for government budget deficit financing	Turnover tax	Particular treasury for turnover tax	Comptoir d'Escompte, Paris, Länderbank, Vienna Berlin Merchant Society
5% Lottery Loan (1888) for repurchase of revenues from tobacco monopoly	State monopoly on imports of tobacco	Government Budget	Viener Bankverein
Railways Rent (1890) for Repurchase of Railways	Revenue from Railways	Government Budget	French banking syndicate, Paris

Salt loan from (1890) for repurchase of revenues from salt monopoly	State monopoly on imports of salt	Government Budget	French Banking Syndicate, Paris Länderbank, Viena Berlin Merchant Company
Loan on 16% additional tax (1893) fro government budget deficit financing	Additional tax for military needs, surplus from revenues of State monopoly of imports of salt	Government budget	Länderbank,Vienna Berlin Merchant Company Ottoman Bank, Paris
Loan on account of Railway Directorate (1893) for government budget deficit financing Conversion Loan (1895)	Revenues of Railway Directorate Net revenue from Serbian Railways*, administrative taxes, revenues from tobacco, salt and petroleum monopoly, import duties, revenues from turnover tax	Government Budget	French Banking Syndicate, Paris Länderbank,Vienna Berlin Merchant Company Ottoman Bank, Paris
Exploitation Loan (1899) for government budget deficit financing	Revenues from Serbian Railways	Independent Monopoly Directorate	Union Bank, Vienna
Monopoly Loan (1902) for government budget deficit financing	Revenue surpluses of Independent Monopoly Directorate	Independent Monopoly Directorate	French Banking Syndicate
Railroad Construction and Army modernization (1906)	Revenue surpluses of Independent Monopoly Directorate	Independent Monopoly Directorate	Syndicate of French and Swiss Banks led by Franco-Ottoman Bank
Railroad Construction and Army modernization (1909)	Revenue surpluses of Independent Monopoly Directorate	Independent Monopoly Directorate	Syndicate of French and Swiss Banks led by Franco-Ottoman Bank
Loan of Uprava Fondova (1910)	Mortgage Bonds of Uprava Fondova	Government Budget	French Bank for Trade and Industry
Communal Loan of Uprava Fondova (1911)	Mortgage bonds of Uprava Fondova	Government Budget	French Bank for Trade and Industry Franco-Serbian Bank, Paris
Loan for Balkan Wars (1913)	Revenue surpluses of Independent Monopoly Directorate	Independent Monopoly Directorate	French Banking Syndicate led by Franco Serbian Bank, Paris

Source: D Gnjatović: Stari državni dugovi, prilog političkoj i ekonomskoj istoriji Srbije i Jugoslavije 1862-1941, Jugoslovenaski pregled, Beograd, 1991.

Annex Table 4

External Debt of Serbia 1867-1912,
in Dinars (Fr. Francs)

1867	2,350,000	1891	322,252,868
1868	2,303,000	1892	316.170,041
1869	2,256,000	1893	340,692,542
1870	2,209,000	1894	362,452,542
1871	2,162,000	1895	413,103,700
1872	2,115,000	1896	411,795,000
1873	2,068,000	1897	410,537,500
1874	2,021,000	1898	407,403,929
1875	1,974,000	1899	424,223,720
1876	7,252,000	1900	420,799,149
1877	7,093,479	1901	417,139,578
1878	6,934,908	1902	414,854,199
1879	6,776,337	1903	471,449,628
1880	6,617,776	1904	467,856,628
1881	139,459,196	1905	464,263,628
1882	152,243,624	1906	460,670,628
1883	150,740,203	1907	552,077,628
1884	189,506,782.	1908	547,959,628
1885	257,936,861	1909	543,841,628
1886	280,533,165	1910	689,723,628
1887	278,152,327	1911	684,705,628
1888	306,771,489	1912	679,837,628
1889	303,590,651		
1890	327,076,313		

Source:

Statistički godišnjak Kraljevine Srbije za 1893, Beograd, 1893;
Statistički godišnjak Kraljevine Srbije za 1894-1895, Beograd, 1898;
Statistički godišnjak Kraljevine Srbije za 1896-1897, Beograd, 1900;
Statistički godišnjak Kraljevine Srbije za 1898-1899, Beograd, 1905;
Statistički godišnjak Kraljevine Srbije za 1902, Beograd, 1905;
Statistički godišnjak Kraljevine Srbije za 1904, Beograd, 1906;
Statistički godišnjak Kraljevine Srbije za 1905, Beograd, 1907;
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Zbirka zakona, ugovora i pogodaba o srpskim zajmovima, Uprava drzavnih dugova, Ministarstvo finansija, Beograd, 1899;
Zbirka zakona, ugovora i pogodaba o konsolidovanim zajmovima Kraljevine Srba, Hrvata i Slovenaca, Ministarstvo finansija, Beograd, 1924.

Annex Table 5

External Debt Repayments as a Percentage of Government Revenues of Serbia 1880-1912

Fiscal Year	External Debt Repayments (Principal + Interest Repayments), in Dinars (Fr. Francs)	External Debt Repayments as % of Government Revenues
1880	536,887	2.80
1881	536,887	2.09
1882	7,586,887	29.53
1883	8,571,887	30.27
1884	8,571,887	26.26
1885	10,651,887	27.49
1886	14,485,662	45.03
1887	16,187,804	42.34
1888	16,187,804	43.02
1889	18,537,804	50.29
1890	18,537,804	44.17
1891	20,573,736	36.20
1892	20,573,736	39.80
1893	20,573,736	36.97
1894	21,119,736	36.55
1895	20,100,600	34.38
1896	20,100,600	33.71
1897	20,100,600	32.61
1898	20,100,600	30.53
1899	19,565,600	27.14
1900	20,686,600	27.47
1901	20,337,713	25.52
1902	19,802,713	25.18
1903	23,102,713	25.10
1904	23,102,713	20.96
1905	23,102,713	25.16
1906	23,102,713	25.31
1907	27,902,713	28.52
1908	27,902,713	29.28
1909	27,902,713	26.54
1910	35,402,713	30.37
1911	35,402,713	26.97
1912	35,402,713	28.28

Source: As for Annex Table 1 and Annex Table 4.

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