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THE MAIN CAUSES OF THE GREATEST HYPERINFLATIONS

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Abstract: *Hyperinflation represents a very high and rapid inflation that completely destroys the economy of one country. The aim of this paper is to investigate the greatest hyperinflations that have occurred to date in the world and to highlight the key causes that have affected their occurrence and development. This research should contribute to the enrichment of the existing literature and to the current knowledge of hyperinflations, thus increasing the possibilities of early detection of hyperinflations and their prevention. Four greatest hyperinflations will be analyzed (Hungary, Zimbabwe, Yugoslavia, Germany) using statistic data and available literature. Research will confirm that budget deficit is one of the main causes of hyperinflations and that every hyperinflation can be prevented by the timely decisions of economic policy makers.*

Keywords: *inflation, hyperinflation, main causes of hyperinflations, budget deficit.*

1. Introduction

Inflation is as old as the market economy. Inflation today is a general global problem, so that among the main economic policy objectives of most modern states, the fight against inflation keeps the central place. There is a lot about inflation, but insufficiently enough to be able to "cure" it. It can affect both developed and undeveloped countries, small and large countries. There is no single opinion about the definition of inflation. However, touch points of all definitions are that inflation on one hand means a rise in prices, and on the other hand a decrease in the purchasing power of money (Veselinović, 2010).

Hyperinflations include those inflations that are rapidly evolving and in which price growth exceeds the 30% annual limit (Cagan, 1953). Hyperinflation does not arise suddenly, but it develops in the longer term. Once it occurs, it takes up true acceleration as a result of the cumulative effect of real, monetary and psychological factors. Namely, at the time of hyperinflation, consumption is rapidly increasing, goods are disappearing from the market, and speculative jobs are gaining dramatic proportions. All transactors want to get

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rid of the money as soon as possible, as it starts losing its value very fast, and they start turning it into the real goods or convertible currencies (currency substitution). As a result, we have the printing of money in infinity, but also a significant increase in money speed. However, during this period, there is a lack of money, because prices are rising faster due to the installation of the so-called inflation expectations in prices. In order to prevent a hyperinflation, firstly, it is crucial to discover the causes that led to such a performance. As soon as the causes of such phenomena are detected, sooner the consequences will be removed. Therefore, the issue of hyperinflation becomes a key issue of study and the center of interest of a large number of economists. This is precisely the purpose of this research, the detection of the key causes that lead to hyperinflation.

By simply observing the hyperinflations that have occurred in the world until today, it can be noticed that hyperinflations usually occur during the war prepares or during the wars, and are ending catastrophically immediately after the war. In addition, there are several other historical and political factors that create favorable conditions for the development of hyperinflation. Those are: expressed political instability, transition, disintegration of the country, weakness of democratic social institutions, social inequality, chronic inflation, etc. (Jakšić, 2013). It is considered that the analysis of hyperinflation is simpler than the analysis of inflation precisely because of its extreme nature. By analyzing the findings of the past, it can be concluded that a large number of theorists agree that the main cause of the occurrence of hyperinflation is the budget deficit, followed by irregular decisions by the authorities about its coverage (such as excessive printing of money). So, in the following, the focus of attention will be dedicated to this cause of hyperinflation. In connection with this, the question that arises is whether the budget deficit is actually the cause of hyperinflation, or, on the contrary, inflation leads to the creation of a budget deficit. What opinion will be accepted depends on the time when the deficit occurred, before or after inflation (Bernholz, 2015).

The conclusion is that hyperinflation is always a state phenomenon, that is, that it is a state's responsibility, either objective, or subjective responsibility. Accordingly, it can be noticed that the causes of the emergence of hyperinflation lie in a catastrophic economic policy (when inflationary financing of the budget dominates, and the inflation runs out of control and explodes) or even in the conscious intention of the government to provoke inflationary chaos (Jakšić, 2013). It is concluded that almost every hyperinflation can be prevented by the right decisions and effective measures undertaken by the authorities. These are also some of the hypotheses to be considered in this research.

So far, around 30 hyperinflations have occurred in the world (Bernholz, 2015). Below, using the method of analysis of statistical data, I will try to prove the previous hypotheses in order to contribute in this way to the existing literature dealing with the analysis of hyperinflations and especially the causes of hyperinflations, in order to prevent the emergence of hyperinflations in the future. The four biggest hyperinfections in the world to date will be analyzed, and those are Hungary, as the country that has faced the largest hyperinflation in history, Zimbabwe, Germany and Yugoslavia.

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2. Methods

2.1. Causing hyperinflation in Hungary by introduction of inflationary tax

Starting from the middle of 1945. until the middle of 1946. Hungary has survived the greatest hyperinflation in history. Hungary's government was using a inflation to increase the revenues, and inflation has simple run out of control (Nagaro, 1948). Namely, Hungary was confronting to big payment requirements which was very difficult to achieve because of the war consequences. All government revenues from standard sources, such as taxes, were able to cover less than 10% of government needs. In order to get capacity extension, government has introduced an inlatory tax, that is, a separate currency for tax collection - tax pengo.

One of the causes of hyperinflation in Hungary is also the initial shock on the supply side. Namely, the rise in prices was inevitable, due to the reduction in the aggregate supply, which could not satisfy the aggregate demand. Since the government could not print money because it did not have the money printing equipment, it can not be said that the government caused hyperinflation with excessive money printing. It can be noticed that it depends of the actions of the monetary authorities whether hyperinflation will continue or not, but also history shows that the supply disorder, and not the expansion of money, is what, in fact, leads to price increases (Horvath, 1983). For hyperinflation in Hungary, it is also important that after the war, the railway line was completely disabled. Thus, even though the goods were produced in one part of the country, producers could not place those goods on the market except at much higher prices. Cross-border trade was also reduced. Then, although the amount of money in circulation grows at a relatively small percentage, the rate of its temporary increase is high because of the rapid conversion of money into goods.

Table 1. Banknotes in circulation monthly during the hyperinflation in Hungary

Month	Banknotes in flow
July 1945.	25.433.900.000
August 1945.	35.521.100.000
September 1945.	51.034.100.000
October 1945.	115.961.100.000
November 1945.	364.592.000.000
December 1945.	765.446.300.000
January 1946.	1.646.450.000.000
February 1946.	5.237.808.300.000
Mart 1946.	34.001.636.300.000
April 1946.	434.304.091.200.000
Maj 1946.	65.588.977.992.200.000
Jun 1946.	6.277.271.200.000.000.000.000
Jul 1946.	47.300.000.000.000.000.000.000

Source: Grossman Z. P. & Horvat J. (2000). The Dynamics of the Hungarian Hyperinflation, 1945-6: A New Perspective. Indianapolis: Butler University, p. 418.

As it was previously said, the Hungarian authorities faced the reality of the shocks on the supply side initially and subsequently with an inflationary jump. What authorities believed was that inflation should be used to increase the employment of production factors and hence the national income. The rapid growth of money was meant to lead to a rise in demand that was supposed to stimulate spending and increase supply. The assumption is that in times of high inflation, it makes little sense to hold money and that therefore the money is quickly turned into goods and the existing capital is more fully used. The Hungarian authorities considered that inflation can also be used to stimulate investment and increase employment much more than stimulated demand. The aim was to stimulate business people and not consumers to invest in productive activities.

As inflation intensified, the popularity of tax pengó bills rose. This led to a very sharp growth of the ratio deposit-banknotes (the ratio of the amount of money deposited in banks in relation to the amount of money in circulation) in the period from January to April 1946. Until June 1946, it was almost impossible to find a regular currency pengó in circulation in Budapest and other cities. In addition to the tax pengó deposited in banks, since May 21, 1946, tax pengó notes have been printed and used. Originally, they were used to pay taxes. Soon, the Minister of Finance expanded the use of tax pengó notes to cover some payments (consolidated public accounts, railway taxes and other public services). During the massive rejection of the regular currency that followed, the Government decided to further extend the use of tax pengó notes and it began to pay all the costs from these notes. So, the issued notes got the function of temporary paper money. On July 9th, tax pengó notes become legal means of payment and their printing and distribution was taken over by the Central Bank. These notes become the medium of exchange in Hungary. On August 1946, astronomic growth of prices was stopped and permanent price stability was established. Tax pengó notes became an auxiliary and irrelevant currency that was gradually withdrawn from use until the beginning of 1947.

2.2. Over issuing money and occurrence of hyperinflation in Zimbabwe

In March 2007, hyperinflation occurred in Zimbabwe - defined as an inflation rate that exceeds 50% monthly. It destroyed Zimbabwe's economy, pushing an increasing number of citizens to poverty and plunging millions into emigration (Hanke, 2008).

In the period from 1997 to 2007, the rate of hyperinflation was almost 3.8 billion %, while the living standard, measured by real GDP per capita, also drastically dropped. In addition, hyperinflation robbed people by swallowing their savings roles. This type of theft occurred, mainly because people under compulsion of legal and other regulations were forced to invest their money or to buy state treasury bills that were bringing a small portion of the current inflation rate or to deposit funds with the National Bank of Zimbabwe that was not paying interest on deposited amounts.

The value of the local currency (Zimbabwean dollar) has disappeared. The government emitted money to finance its participation in the Democratic Republic of the Congo and in 2000, the Second Congolese War, including more wages for military and government officials. Another motive for excessive money laundering was printing money for own needs and corruption. It can be concluded that the main reason for the phenomenon of hyperinflation lies precisely in the state policy, expressed in the uncontrolled printing of cash without cover. One of the causes was also a land reform which reduced agricultural

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production, especially production of tobacco, whose exports made 1/3 of Zimbabwe's foreign exchange earnings. Production and mining were also declining. All the measures prescribed by the Government (higher denominations or the announcement of new currency arrangements) couldn't achieve a monetary stability. Therefore, one of the reasons why the currency continued to lose value is also that a large number of people expected this.

Table 2. Movements of value of domestic currency in Zimbabwe (Zimbabwean dollar)

Date of redenomination	Currency code	Value
1 August 2006	ZWN	1 000 ZWD
1 August 2008	ZWR	10^{10} ZWN = 10^{13} ZWD
2 February 2009	ZWL	10^{12} ZWR = 10^{22} ZWN = 10^{25} ZWD

Source: Hyperinflation. Retrieved from: <http://www.wikiwand.com/en/Hyperinflation>

Despite the duplication of number of employees in the Central Bank of Zimbabwe, this institution couldn't not provide accurate and timely data. Therefore, it was decided to replace the system led by the Central Bank with the new monetary system, in order to convince the citizens that in the next period the inflation will be controled. The best option for fast replacement of the Central Bank of Zimbabwe was the currency board (a monetary institution issuing banknotes and coins). The monetary obligations of the currency board had fully support in foreign reserves, which is also called the anchor currency and which, if necessary, was converted into a reserve currency at a fixed rate. As a reserves, the currency board took into account low-risk interest-bearing securities, but also other funds chargeable in reserve currency. The currency board was, according to the law, obliged to hold reserves with a hundred percent coverage or more, from the banknotes and coins that were in circulation. Financial liberalization was critically important to the economy of Zimbabwe. The fastest way to return Zimbabwean capital is its imports. To achieve this, a stable currency and a liberal financial system are required. Other forms of "financial repression" (interest rate ceiling, forced repurchase of government bonds, minimum reserve requirements for financial institutions) should also be banned. This liberalization should ensure the free flow of capital to and from Zimbabwe. It is also necessary to increase the passive interest rate on savings and reduce the cost of capital in Zimbabwe, eliminating the main barriers to economic growth and improved living standards.

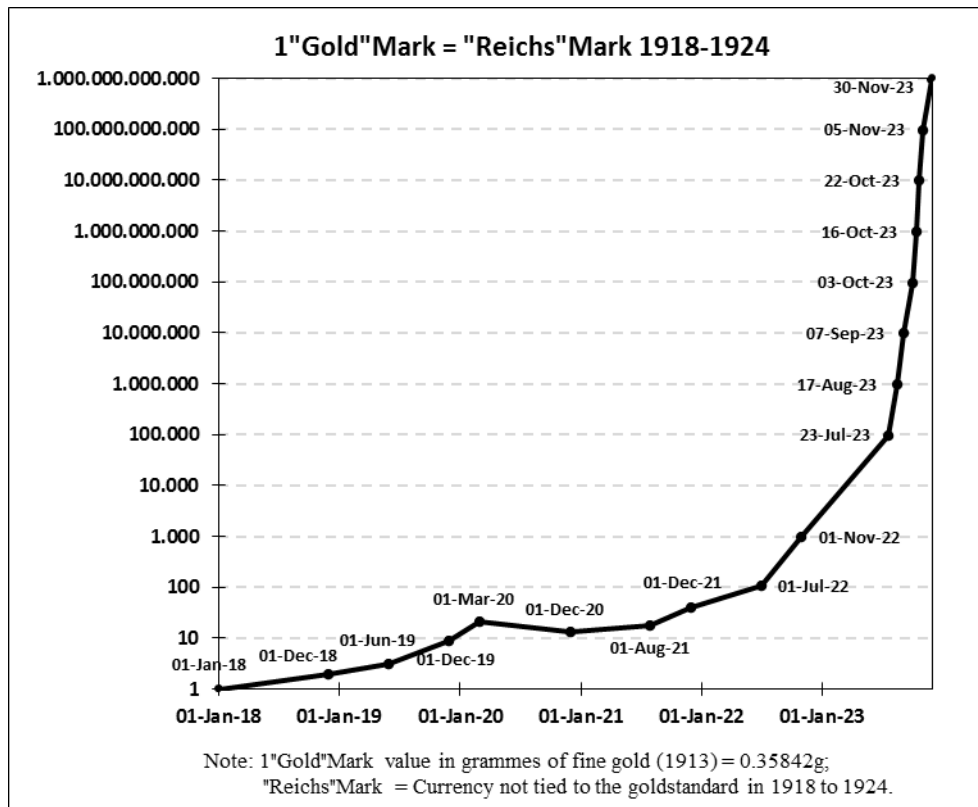
2.3. Hyperinflation in Germany caused by high after war reparations

Hyperinflation in the Weimar Republic lasted for three years, from June 1921 to January 1924. French and British economists have argued that Germany has destroyed its economy with the aim of avoiding reparations. The main cause of hyperinflation in Germany was the payment of reparations that the Allies required from Germany according to the Treaty of Versailles. This agreement required Germany to accept full responsibility for the First World War and to pay full war expenses. The Allies have determined the amount to be paid, which of course was higher than the gross domestic product of the whole country. Until February 1920, inflation was not changing. In the next 15 months, the

price index was kept stable. The official currency of Germany - Mark even gained some value in relation to foreign currencies, so that the import prices fell by about 50%. However, over these 15 months, the government continued to issue new amounts of money. Money in circulation increased by 50%. In May 1921, the price inflation started again, and by July 1922 prices rose 700%. The German central bank continued to issue a new amounts of money, but much slower than the rate at which prices were rising. After July 1922, the phase of hyperinflation began.

When Germany stopped paying reparations, in January 1923, France and Belgium occupied the German industrial area Ruhr to take whatever they could. In response, workers from that area entered a general strike against foreign occupiers and refused to work for them. At least, this strategy forced the French and Belgians to leave this area, but it brought a standstill in the German economy. Factories throughout the country had to be closed because they did not get the raw materials they needed from the Ruhr region.

Illustration 1. Price of gold in Germany during period of 1918-1924. Year



Source: Hyperinflation. Retrieved from: <http://www.wikiwand.com/en/Hyperinflation>

In the following period, the companies were operating at a huge speed and unemployment was gone. However, the real wages of workers fell to a miserable level. Unions often asked for increases, but this could not always be realized. Domestic workers, farmers, and "white collar workers" especially went badly. They did not have trade unions

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to fight for increased profits for them and were often starving. However, in this period, the shops were more often empty. Workers in the warehouses could not accommodate so many goods that were required, or simply because of the speed of the goods turnover, they could not accomplish it so fast. Farmers refused to place products in cities in exchange for worthless money. Enterprises have begun to close and unemployment suddenly grows. Middle class members who had any kind of fixed income have become poor. Hospitals, various associations, as well as charity and church organizations were shutting down as the funds from which they were financed were disappearing.

In November 1923, a currency reform was carried out. The new bank, Rentenbank, was founded to issue a new Rentenmark currency. This money was convertible for bonds issued on the basis of ownership of land and industrial plants. From that moment on, depreciation stops - Rentenmark retains value: even the old Mark remains stable. Inflation is over. In August 1924, the reform was completed by the introduction of Reichsmark, whose value was equal to Rentenmark. Reichsmark had 30% gold coverage. How inflation has ended tax revenues have grown significantly.

2.4. High costs and wrong government decisions as a cause of hyperinflation in Yugoslavia

Prior to the period between 1990 and 1994, inflation has been constantly present for decades. The causes of inflation were various: excessive short-term corporate lending, monopoly policies, wage growth, growth of taxes, exchange rates and other costs, budget deficit. The dynamics of inflation were different, but with the tendency of acceleration: from several tens of percent annually during the seventies and eighties, to up to twenty-digit inflation in 1993. (Bisić & Mijatović, 1996 p. 1). One of important factors was the pressure of individual republics for a bigger part of government expenditures than they could have financed by taxes or by borrowing, and the growing regional conflict because of the problem of paying external debts and the arguing about who and how much (members of the former SFRY) should pay. However, it can not be said that the regional problem was the only cause of our inflation. After the breakup of 1991, Yugoslavia became a more homogeneous state, but then it experienced one of the highest inflation in the history. The big problem was financing of the huge and bulky administrative machine of Yugoslavia.

The central issue in the late spring and summer in 1992 was a calming down of inflation. During the first four months of 1992, it was about 45% monthly, measured by the increase in retail prices (Avramović, 2007 p. 4). At first, it seemed that our economy could function at that pace of inflation, but the problem arose in May 1992, when inflation jumped to 80%, and in June at 100% a month, and this has created anxiety in almost all markets. In the summer and early autumn of 1992. (Avramović, 2007 p. 9), Yugoslavia reduced the pace of inflation to below 50% per month. This is the result of the Stabilization Plan of 1992, aimed at a sharp decrease in money supply growth, which will result in a reduction in price growth with simultaneous price control. This meant that all planned price increases had to be reported to the price office before the increase was applied, and for "vital products", the "frozen" regime was in effect. In the spring of 1993 prices were rising again at a rate far above 100% a month. Yugoslavia's state costs after the Croatian army's attack on the bridge over Maslenica were greatly increased and maybe this is the reason for acceleration of inflation. It also coincided with the resignation of the previous government.

Three factors contributed to the acceleration of our inflation and its transition to hyperinflation in the spring of 1993. (Avramović, 2007 p. 9). A combination of large indebtedness of companies and speculators due to lower interest rates, an unlucky announcement by the NBY that it is going to buy the entire harvest and extensively maximizing of prices by the government, added to the already high inflation, caused a mass escape from the dinar into goods and foreign currency - a blow at the beginning of July 1993, from which the Yugoslav monetary system could no longer recover. The escalation of hyperinflation happened in August 1993 after the emission of 300 billion dinars for the purchase of wheat, when the price increase of 1,880% was recorded. During this period, two large pyramid banks - savings banks (Jugoskandik and Dafiment Bank) were created. The essence of their business was to: promise huge foreign currency interest rates (15% or more) and thus attract as many depositors as possible. New depositors were servicing the interest rates of existing depositors, which in 1993 led to the collapse of financial system.

Table 3. Price movements in Serbia from July 1993. to January 1994. year (in %)

Month, year	Monthly rate of inflation	Yearly rate of inflation	Daily inflation	Hourly inflation
July, '93	431.6	2.2×10^6	5.37	0.23
August, '93	1,881.0	3.2×10^7	10.07	0.40
September, '93	643.2	1.5×10^8	6.69	0.27
October, '93	1,856.0	1.9×10^9	10.38	0.41
November, '93	20,290.0	2.8×10^{11}	18.77	0.72
December, '93	1.78×10^5	3.5×10^{14}	28.30	1.04
January, '94	3.13×10^8	5.2×10^{20}	61.83	2.03

Source: Dimitrijević B. (1996). Hiperinflacija. Belgrade: Svetlostkomerc, p. 372.

Fiscal revenues experienced maximum erosion as inflation was accelerating in 1993. At the same time, the "gray" economy, that was not paying the tax, has grown, which has improved its competitive position in relation to the companies that were paying the tax. The payment of wages in kind, mainly in food, has increased. It was convenient for workers as they were saving one part of their real compensation, and it also for businesses, as they were reducing their total tax contributions. On the other hand, was difficult for the fiscal situation of the state. In the second half of 1993, three giant machines were working and were producing unsustainable inflation: the rise in the price of foreign currency caused by avoiding dinar, the expansive credit policy of the cheap money and the deficitary state spending almost without limit. These three factors were supporting one another.

Starting from August 1993, more stabilization programs were appearing at same time. Then the work of the Expert team of project coordination was followed. Of all the proposals presented in these programs, only freezing prices and an attempt to plan production were applied. The monetary system reconstruction program consisted of 13 points (Avramović, 2007). The key place in the program took the introduction of the new

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dinar, where one dinar worth was equal to one German Mark worth. Relationship 1: 1 was established only for psychological reasons, for using the advantages of clarity of simplicity.

3. Results and Discussion

As it has been stated previously, hyperinflation is one dangerous phenomenon and it is very difficult to get over it. In every single case it occurs in different circumstances, has different appearances, characteristics and at the end it is never resolved in the same way. However, it can be concluded that hyperinflation is a state phenomenon which government is able to control. In order to get over hyperinflation, one economy, firstly, has to know the causes which have produced the hyperinflation and how it is developing, and then it should react using careful interventions which are part of the special stabilization programs. It can be noticed that hyperinflations usually appear as a consequence of war, payments of reparations and other debts, covering of budget deficits, as a consequence of country decomposition. In all of these cases and many others, hyperinflation has appeared because of the covering of budget deficit using money from primary emission.

When analyzing the greatest hyperinflations which have occurred in the world until today, we can notice that the second hyperinflation in Hungary was the greatest. Hyperinflation that occurred in our country after the decomposition of SFRJ was on the second place during fifteen years. Hyperinflation in Zimbabwe came on this place at 2008. and it is at the same time the latest hyperinflation that have occurred. Hyperinflation in Zimbabwe moved hyperinflation in Yugoslavia on the third place. Hyperinflation in Hungary occurred after the Second World War 1946. when the daily inflation reached 207%. In Yugoslavia, inflation reached 64,6% daily. But Zimbabwe has later noted the daily inflation of 98% where the prices were doubling on every 24,7 hours. Germany keeps the fourth place with the hyperinflation of 20,9% daily, and prices tripled every 3,7 days.

Table 4. Key causes of four greatest hyperinflations

Country	Causes of hyperinflations
Hungary	- introducing inflatory tax (tax pengo) in order to cover high war costs
Zimbabwe	- corruption and overissuing money for financing and own needs
Germany	- paying too high afterwar reparation, printing money and state riots
Yugoslavia	- perennial inflation, high state expenditures and wrong state decisions

We can conclude that the main causes of analyzed hyperinflations were mainly the wrong government decisions and that almost all of these hyperinflations could be prevented. Thus, in Zimbabwe, before and during hyperinflation, the government was made of corrupted people. Those people were covering the biggest part of costs (like share in Democratic Republic of the Congo and the Second Congolese War) using money printing, and they were also printing money for their own needs. Similarly, in Yugoslavia, the government was making wrong decisions about costs financing (by printing money). The amounts of money necessary for covering these costs were also too high because of their bad government

management (high administration costs, high external debt, excessive short-term corporate lending, monopoly policy, wage growth, taxes).

In Germany and Hungary the situation was a little different, regarding that the wrong government decisions were caused by wars, and thus, it cannot be claimed that these hyperinflations could be prevented. This is definitely the case with Germany, where it was impossible to pay all afterwar costs and reparations. Moreover, Germany was not paying only its own costs, but also reparations to its allies as it was stated previously. On the other side, even that there was a war, the government has significantly contributed to boosting inflation and turning it into hyperinflation. In particular, this refers to the introduction of an inflationary tax, that is, a tax penny, which has led to the greatest hyperinflation in history.

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KLJUČNI UZROCI POJAVE NAJVEĆIH HIPERINFLACIJA

Apstrakt: Hiperinflacija predstavlja veoma visoku i brzu inflaciju koja u potpunosti uništava ekonomiju jedne zemlje. Cilj ovog rada je istražiti najveće hiperinflacije koje su se do danas odigrale u svetu i ukazati na ključne uzroke koji su uticali na njihovu pojavu i razvoj. Naučni rad na ovaj način treba da doprinese obogaćivanju postojeće literature i dosadašnjih saznanja o hiperinflacijama, i na taj način poveća mogućnosti ranog otkrivanja hiperinflacija i njihovog sprečavanja. Istraživanje će se usmeriti na analizu četiri najveće hiperinflacije (Madjarska, Zimbabve, Jugoslavija, Nemacka), a u analizi će se koristiti statistički podaci i dostupna literatura. Ovom analizom ukazaće se na to da je jedan od osnovnih uzroka hiperinflacija budžetski deficit i da je svaku hiperinflaciju moguće sprečiti pravovremenim odlukama nosilaca ekonomske politike.

Ključne reči: inflacija, hiperinflacija, ključni uzroci hiperinflacija, budžetski deficit.