

Positions of the Austrian School on currency policy in the last decades of the Habsburg monarchy (1892-1914)

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1. The currency reform in the Habsburg monarchy of 1892¹

After a long period of debate about reform of the monetary system of the Habsburg monarchy, the parliaments of Austria and Hungary passed identical laws in August 1892 that enabled the Austro-Hungarian bank (A-HB) to establish a gold backed currency. The Austrian guilder (Gulden, fl) had been a pure paper currency since 1879. A 10 fl gold coin issued in 1878, equivalent to 24 ffr, which served as a connecting bridge to the international currency system traded against paper notes for some 11,50 (the so-called “gold agio”) in 1879. This ratio increased to 12,4 in 1887 and then declined to 11,7 in March 1892. In view auf this reversed trend, industrial and agricultural interest groups which had opposed the adoption of the gold standard for many years, turned into supporters in fear of continued appreciation which would have worsened their international competitive position.

At the time when the final decision was made, the money supply of the monarchy consisted of bank notes, so-called state notes (*Staatsnoten*), and silver coins. The A-HB’s metal reserves in gold and silver were sufficient to fulfil the requirement for metal coverage of its own bank notes. The governments of Austria and Hungary committed themselves to withdraw state notes amounting to 412 million fl (824 million K) from circulation and replace them by gold until the end of 1899². The provision of the gold reserves had to be financed by issue of government bonds on international financial markets. In this scenario, mandatory resumption of specie payments (*Barzahlung*) was envisaged as final step of the currency reform, which would become possible as soon as the state notes would have completely disappeared from circulation. However, no date was set as to when the A–HB would be obliged to payment in specie. For the time in between, the A-HB was obliged to prevent an increase of the exchange rate above gold parity, whereas it remained at the bank’s discretion to counteract a movement in the opposite direction.

¹ Descriptive information on the development of the monetary system of the Habsburg monarchy is based on Fellner 1911 and Kamitz 1949, condensed to a minimum for the sake of brevity.

² More precisely, circulating state notes of 1fl denomination lost legal tender status after 1899. State notes of higher denomination were replaced by fully covered bank notes and silver coins and ceased to be legal tender in 1903. For details see Fellner 1911, pp. 125ff.

The introduction of a gold backed currency was overwhelmingly supported by an expert commission established jointly by the finance ministries of Austria and Hungary. If only two members of the expert commission advocated a bimetalist currency system, they could support their case by pointing to the fact that in 1892 silver still accounted for almost 60 percent of the metal reserves of the A-HB. Its immediate replacement by gold, but also a decision to keep a substantial portion of reserves in silver entailed considerable risks for the success of the currency reform. Hence, the future composition of reserves and of money circulation remained a controversial issue, as well as the choice of the currency unit and other modalities.

2. Carl Menger's writings on the introduction of the gold standard

Carl Menger actively engaged in the debate reform as member of this commission as well as through several publications. Against the two votes in the expert commission in favour of a bimetalist currency system Menger argued that the adoption of the gold standard did not imply complete elimination of silver from reserves and circulation. The experience of Germany demonstrated the viability of a kind of "limping currency system" (*hinkende Goldwährung*)³. Moreover, if in the case of the guilder between 1879 and 1892 Austria's currency consisted of paper money not backed by reserves of precious metal, this would be possible also for a much smaller volume of circulating silver coins.

The central issue of the currency reform was, of course, the weight, or gold content of the new currency unit (1K=2fl). The majority opinion in the commission tended to fix the gold content of the guilder at an exchange rate of 2,102 ffr for 1 fl (or 1,051 ffr for 1 K) which was almost identical with the actual rate at the time of the final debate and slightly higher than the 13 year-average (1879/91). Menger pleaded for a lower gold content ("light guilder") equivalent to an exchange rate of 2,05 ffr for 1 fl. He supported his position with two main arguments. First, the appreciation of the guilder of some 8% between 1886 and 1891 had been caused by high surpluses in the trade balance of the monarchy which Menger did not expect for 1892 and the following years.⁴ The going exchange rate (March 1892) therefore had an upward bias, even though it had dropped below the rates prevailing in 1891. Still more importantly, the likely consequence of the adoption of the gold standard by a big European power like

³ Menger 1892a, p. 170ff

⁴ Menger 1892b, pp. 201ff

Austria-Hungary would be an increase in the price of gold. To avoid possible negative effects, Menger advised not to fix the gold content of the guilder at the date of transition but to wait and see how the gold price would develop until completion of the major part of the purchase.⁵ Moreover, a guilder whose weight is too high entails the risk that a gold agio might reappear.⁶ Eventually, the weight of the crown was fixed at 1K equivalent to 1,05 ffr.

Menger's cautious, comparatively "soft" position on the exchange rate-issue was based on his theoretical considerations. For Menger, negative effects on economic activity in general could be expected not only from a decrease of the value of money but also from an increase. "Appreciated money is no less an anomaly of the national economy, in some respects even more pernicious, than depreciated money."⁷ And : "What pernicious consequences for our commerce and for the whole economy money would necessarily have if its purchasing power would rise from year to year and from decade to decade and change all obligatory relations accordingly, hardly needs to be called to special attention."⁸ Money serves its function best if it is protected against an increase as well as a decrease of its value.⁹

Menger's testimony before the enquete commission contains an important message for the national bank: that it must be ready to intervene in order to smoothen the effects of inward and outward flows of money. "The people cannot (be expected to) take the necessary precautions to equalize the balance of payments in international money, i.e. in gold, if the need emerges. The Bank must be the precaution for the people. Under present conditions it has the great task to settle the international balance in circumstances where the (private) economy could achieve this only by accepting great sacrifices."¹⁰ This recommendation follows directly from Menger's theory of money under uncertainty.

Menger's cautious attitude with respect to the exchange rate appeared to be justified when the the gold agio reappeared in October 1892. The highly undesirable return of the agio underlined the significance of Menger's recommendation that "the Bank must be the precaution for the people." The agio reached its peak at 6,75% in 1893. For economists and politicians this phenomenon was both a great puzzle and a matter of great concern.

⁵ Menger 1892c, p. 266

⁶ Menger 1892b, pp. 217ff

⁷ Menger 1892b, p. 206

⁸ Menger 1892a, p.156; see also Menger 1892c, p. 257

⁹ Menger 1892b, p. 207

¹⁰ Menger 1892c, p. 250

Menger mentions several factors which contributed to the temporary fall of the exchange rate: a seasonal pattern in the balance of commodity trade, with exports peaking in the first half of the year; the backflow of a greater part of outstanding securities (including those issued to finance the gold purchases of the governments), excessive and hasty purchases of foreign exchange bills by the A-HB; the failure of the national bank to follow other national banks in raising the discount rate. Menger argued that the agio would not have increased to such numbers if the national bank had reacted immediately by using its gold reserves to buy the securities that were flowing back into Austria. He thought that measures to eliminate the agio in the short run would be costly, while their effectiveness uncertain. Instead, “cure of the evil should be expected from the return of more favourable circumstances.”¹¹

3. Friedrich von Wieser on currency reform

At the time of the Austrian currency reform the fight between advocates of gold and silver, or of some mixture of the two alternatives (bimetallism, limping gold standard) was still ongoing. In the United States, the Sherman Silver Purchase Act of 1890 interrupted the decline of the price of silver for several years¹². Hence, the decision about the future currency system of the Austro-Hungarian monarchy, which was then still one of the major European powers, attracted considerable international attention¹³. Friedrich von Wieser was invited to contribute an article on the subject to the newly founded *Journal of Political Economy* (Wieser 1893).

In his article Wieser gives an overview of the development of the Austrian currency system after the suspension of specie payments in 1848. He argued that the principal question of adoption of the gold standard in Austria-Hungary had been decided beforehand by international developments in the preceding decades¹⁴. With respect to the envisaged resumption of (statutory) specie payments, Wieser thought that the major part of silver reserves would have to be converted into gold. This task would be even more demanding because in addition to the reserves a large amount of silver coins was part of the circulating stock of money. Thus, elimination of silver appeared to be impossible in the near future. If, as

¹¹ Menger 1893, p. 324

¹² Mises 2014, p.11 (editor’s footnote 18)

¹³ A translation of the report of the currency commission appeared in the *Quarterly Journal of Economics* under the title “The Gold Standard in Austria” in 1893.

¹⁴ Wieser 1929, p. 261

a consequence, the monarchy would have a “limping” gold currency, the experience of Germany showed that this was a system a country could live with quite well¹⁵.

When Wieser commented again on the currency situation early in 1894, success of the reform had become more uncertain as the gold agio of the crown had increased above 6 percent. Wieser admitted that there were serious arguments in favour of bimetallism, which was an “effective counterweight against the excesses of overzealous goldmen”. But Austrians, even if they were bimetallists, had to devote all efforts to secure final success of the introduction of the gold standard; even more so, since the middle way chosen offered a compromise between gold and bimetallism.¹⁶

If the governments of Austria and Hungary had hitherto not encountered difficulties to realize the gold purchases according to plan, Wieser also admitted that a shortage of gold at the international markets might result in downward pressure on the domestic price level. Yet, distortions of price levels between gold countries and silver countries would constitute the more serious risk of disturbance of the development of prices. In case that gold eventually appreciated, this would be the lesser evil, because Austria would share it with its trading partner countries.¹⁷

If success of the currency reform could still be endangered, it was from the side of public finances, which had all too often resorted to the issue of paper money in the preceding decades of the century. “The agio is the paper money, and paper money is the budget deficit. “ Since the state budgets of Austria and Hungary had been effectively brought under control, the country “will soon get rid of paper money. There is no reason any more to fear the agio, as long as orderly public finances are maintained.”¹⁸

At the end of his lecture, Wieser expressed disagreement with Menger’s attentism concerning the capacities of the A-HB and the governments to accelerate the elimination of the agio. Austria and Hungary should be determined to proceed with their gold purchases to enable a swift building up of gold reserves of the bank. Instead of waiting for an improvement of economic conditions through the working of spontaneous market forces, it was time to realize

¹⁵ Ibidem, p. 276f

¹⁶ Wieser 1894, p. 17

¹⁷ Ibidem, p. 23

¹⁸ Ibidem, p. 25

that “the economic state (*Wirtschaftsstaat*) which the socialists strive for (albeit in a different fashion) is already in the making”, and to make full use of its powers to complete the reform¹⁹.

4. Ludwig von Mises on resumption of legal payment in specie and economic development in Austria before World War I²⁰

The gradual disappearance of the agio until 1895 and the easy maintenance of de-facto payment in specie thereafter justified a more optimistic attitude towards the state’s ability to preserve monetary stability. Fears that government purchases of gold might encounter serious obstacles turned out to be unjustified. Gold reserves of the A-HB tripled between 1894 and 1900, when they exceeded 1.000 million K. The problem of silver was easily solved by converting the reserves into silver coins of small denominations. To the surprise of the bank and of public opinion, for practical purposes of circulation paper notes of the bank were preferred to gold coins which flowed back to the bank. As a consequence, gold reserves of the bank were even larger than expected. To make specie payments obligatory, a joint decision of the parliaments of Austria and Hungary was required. Obligatory payment in specie supported by Hungary became an issue of economic policy debates in 1903, and again around 1910. Beginning in 1907, Ludwig von Mises published five articles on the currency question. He based his arguments on careful empirical investigation which made extensive use of available statistical material, and also of the existing literature.

4.1. The case for resumption of legal payments in specie

In view of the resounding success of the currency reform, it appeared beyond doubt for Mises that, “since 1896, the Austrian currency has been able to match any of the European gold currencies in terms of stability of its value.”²¹ In his essay of 1909 he discussed the arguments of the opponents of making de-facto payment in specie into a legal obligation.

The A-HB had acquired a high reputation among European national banks for its skilful policy of managing the market of foreign exchange bills which had enabled the bank to reduce the volume of effective gold transactions and thus keep gold reserves in the bank at a high level. The advocates of the status quo argued that the specific foreign exchange policy of

¹⁹ Ibidem, pp. 27f

²⁰ Richard Ebeling’s introduction to Mises 2012 gives an excellent presentation of Mises’ articles in the context of contemporary debates, and also against the historical background. See also Ebeling 2008.

²¹ Mises 1909/2012, p. 38.

the A-HB rested on its power to refuse the release of foreign exchange bills or gold in situations when the demand comes from “pure speculation” which wants to make a profit from higher discount rates abroad. Under conditions of obligatory payment in specie the bank would no more be able to refuse gold or bills to the speculators, with the consequence of a higher level of the discount rate in Austria.

Mises fully acknowledged the success of the foreign exchange regime established by the A-HB and its beneficial effects. “Through this method an enormous power was concentrated in the hands of the Bank, which it employed in the defence of its specie reserves for the good of the entire economy.” (p. 49) Against the defenders of the status quo Mises argued along two different lines. He denied that the bank could have refused the delivery of foreign exchange to any kind of demand by referring to the non-obligatory character of payments, and he also questioned some of the alleged advantages of the bank’s policy. “From an economic perspective, however, the voluntary nature of specie redemption does not really exist, because the historical precedent of making such payments leaves no choice.”²² If the A-HB was in control of exports and imports of gold, it had to compete with demands from of the private sector on the market for bills of exchange. If the rates for foreign exchange rise above the upper gold point, “the bank seeks to counteract the dwindling supply of foreign exchange by timely export of gold”, and if there are indications of increasing speculative demand, it raises its discount rate. (p. 63f)

Furthermore, Mises denied that the bank was able to distinguish between “legitimate demands” for financing real business transactions, and “illegitimate demands” which only want to take advantage of differences in discount rates. (p. 62) As decisive factor for the A-HB’s ability to maintain payment in specie in practice Mises identified the surplus in the monarchy’s “balance of payments”: Official statistics showed that “the balance of payments was in surplus, even if this was achieved only by a considerable export of securities. Therefore, the Austrian economy had sufficient foreign exchange available in order to meticulously meet any foreign demands.”²³ Moreover, if a major Austrian bank had the intention to buy bills of exchange on foreign markets to earn a higher discount, the finance ministry and the A-HB had “enough weapons at hand in order to prevent this undesired gold

²² Ibidem, p.52. At this point, the English translation is not correct.

²³ Ibidem, p. 53, translation slightly changed. It has to be kept in mind that balance of payments is different from today’s concepts of balance of trade and current balance. In reality, the government of Austria and Hungary issued gold bonds on international capital markets – the export of securities in Mises’ words.

export.” How could it be otherwise, since “over the last 25 years legislation has been passed that, more or less, has brought any type of economic activity under the unrestricted discretion of state oversight.” (p. 63)

Mises also doubted the claim of the opponents of obligatory specie payments that the A-HB could keep its discount rate below that of the German *Reichsbank* for a considerable time only because of its manipulative powers. Through its foreign exchange policy the bank has reduced the fluctuations, but not the average height of exchange rates. If Austria’s foreign debt and the interest the country had to pay for long term securities were high by international comparison, this does not necessarily imply that the short term interest rate would also be higher. The situation on the money market and on the foreign exchange market is different. Because of a lower level of long term investment activity in Austria, high liquidity keeps short term rates at a low level. (p. 71f)

In conclusion, Mises argued that the fear that obligatory payments in specie would lead to higher discount rates of the A-HB was unjustified. On the other hand, substantial benefits could be expected from this final step of the currency reform. “It would above all strengthen the international credit of the monarchy which is urgently needed given the monarchy’s enormous foreign debt.... It would quite conspicuously bring to the consciousness of a wider domestic and foreign audience the reality of the currency reform’s success.” (p. 78)

4.2. The controversy with Walther Federn

In 1910 Walther Federn published an extensive reply to Mises article of 1909 in the same journal. Walther Federn (1869-1949) was founder and editor in chief (until 1934) of the Austrian weekly periodical *Der Österreichische Volkswirt*. As a regular contributor to the *Frankfurter Zeitung* and to other journals, he had published short pieces on the issue of payment in specie before, to which Mises had referred in his article. Federn vehemently denied Mises’ contention that the A-HB had never refused the release of foreign exchange bills below the upper gold point. Federn emphasized that “all bankmen active in the business of exchange trade” would confirm that Mises’ contention was contradicted by the facts.²⁴ Federn also supported his contrary claim with several technical arguments. The bank would be quite capable of distinguishing between “legitimate” and purely speculative demand, because speculators needed bills which are immediately payable (foreign exchange for cash),

²⁴ Federn 1910, p. 153f

which the bank refuses to release. (p. 161) At rare occasions, the bank allows the price of foreign exchange bills to rise above the upper gold point. Above that, Federn argued that the dominance of the A-HB on the foreign exchange market was so overwhelming that it could discourage speculative demand to bid up the price of bills on the private market. Since profit margins of speculators are very small, the bank can thwart their intentions by causing a sudden and unexpected decrease of the price of foreign exchange, and the bank has repeatedly made use of this possibility. (p. 163) Federn insisted that there was a principal difference between legal and facultative payments in specie. The A-HB can carry out effective counterspeculation, which it could not if it had the strict obligation to release gold at a fixed price. (p. 166) Critical situations especially at times of political crises had demonstrated the advantages of the status quo. (p. 164)

In his reply²⁵ Mises admitted that Federn's claim that the A-HB would occasionally refuse the release of foreign exchange or gold could be countered only by stating the opposite²⁶. In support of his position, Mises quotes the official statement of the Austrian minister of finance. Yet this statement is ambivalent, it contains a passage which appears to support Federn's position.

The controversy exacerbated when it continued in 1912. In his article on the 4th issuing right of the A-HB Mises maintained that Federn had changed his position, because he did no more insist that the bank allows rate of foreign bills of exchange to rise above the upper gold point²⁷. In his reply, Federn sharply objected against this insinuation. Moreover, he argued that even Mises had admitted that in autumn of 1911 rates had exceeded the upper gold point, and he also quoted figures for 1907 when this had happened before²⁸.

Whereas in his reply of 1910 Mises had confirmed that Federn was "without doubt, one of the few representatives speaking in favour of the advantages from the current currency arrangement in Austria-Hungary that should be taken seriously,"²⁹ when he came back on the controversy in his memoirs, he had changed his attitude towards Federn completely.

Characterizing him in disparaging fashion, Mises denied the economic competence of Federn,

²⁵ Mises 1910/2012

²⁶ „Der Behauptung Federns ... kann allerdings nichts anderes als eine Gegenbehauptung entgegengestellt werden.“ (Mises 2010, p. 412) The translation on p. 98 is not entirely correct.

²⁷ Mises 1912a/2012, p. 109

²⁸ Federn 1912, p. 750f. In my view, Mises' counter-reply (1912b) is not convincing. Remarkably, this piece has not been included in The selected Writings of Ludwig von Mises Volume I.

²⁹ Mises 1910/2012, p. 95

“who was uneducated in economics and had hardly ever read an economic book except Knapp’s State Theory of Money”³⁰. Without charging Federn personally with corruption, Mises claimed that opposition in the media against obligatory payment in specie was financially supported by a secret fund of the A-HB whose earnings came from the foreign exchange trade activities of the bank. One cannot help but suppose that Mises had felt seriously injured in his pride by Federn’s reply against his article, and these feelings of defeat were still virulent when he wrote his memoirs 30 years later.

Other testimonies³¹ depict Federn as journalist of impeccable character. Federn’s main orientation was that of a monetary economist. He wrote extensively on matters of financial markets and banks, also on public budgets. From his numerous analyses of balance sheets of Austrian companies which were published in the regular supplement of the *Volkswirt*, Federn gained deep insights into the structural problems of Austria’s economy. After the German occupation of Austria, Federn emigrated to the USA. He died in New York in 1949.

Also, the *Österreichische Volkswirt*, which continued to be widely read in economic and business circles in Austria and in the other succession states of the Habsburg monarchy after World War I, enjoyed a high reputation of independent and incorruptible judgement under Federn’s editorship³².

A century later, it is impossible to make a definite judgement about who was right in the controversy. As regards the question of a practice of discretionary refusal on the part of the A-HB, there is more support in the literature in favour of its existence than against. Federn’s position is confirmed by Robert Zuckerkandl³³. In his article he quotes a lengthy official statement of the finance minister³⁴ which more or less repeats Federn’s account of the matter. In his essay on 100 years of monetary policy in Austria, Reinhard Kamitz also supports this view³⁵.

³⁰ Mises 1978,, p. 30

³¹ He was characterized by one of his friends “as a liberal, but not in the sense of economic liberalism. For him, liberalism above all meant what the French revolution had called ‘the rights of man’”. (Polanyi 2002, p. 15) Peter F. Drucker (1978, p.124) described Federn as “a venerable, white-bearded, very deaf old gentleman”. Stolper (1960, p. 36) quotes from a letter where Federn is characterized as “einer jener Männer, die ihren Einfluss einzig und allein ihren persönlichen Fähigkeiten und Eigenschaften zu danken haben.“

³² On the *Österreichische Volkswirt* in the interwar period see Chaloupek 2011.

³³ Robert Zuckerkandl (1856-1926) was a member of the Austrian School of economics: he held a chair at the German University of Prague.

³⁴ Zuckerkandl 1913, p. 313ff, p. 325.

³⁵ Kamitz 1949, p. 156.

4.3. Otto Neurath's contribution to the debate

In a short note that appeared next to Mises' 1910 reply to Federn, Otto Neurath pointed to another aspect of the issue. Even if there would be no difference between the status quo and legal payment in specie, Neurath questions whether the state should be unconditionally obliged to release gold "under any circumstances". "Especially in times of armed conflict such procedure hardly seems appropriate."³⁶ In a war, a large gold treasure is more important than payment in specie. Neurath mentions the crisis of 1848, when an earlier suspension of in specie payments would have been beneficial. He obviously avoided to say explicitly that Austria was a country which was highly exposed to the risk of becoming involved in armed conflict. But he gave the unmistakable hint that "experience had showed the great advantages of a secret exchange rate policy with differentiated treatment of the public."³⁷

5. Sustainability of payment in specie

Of course, more important in substance is the question whether the Austro-Hungarian monarchy could have maintained its gold-"core" currency (*Goldkernwährung*), either with or without legal in specie-payments. Perhaps even Mises had become more sceptical on this issue because he did not explicitly repeat his demand in his article of 1912. Until 1910, he appears to have been firmly convinced that financial stability of the monarchy was sufficient to ensure the sustainability of legal payments in specie. His judgment mainly rests on the fact that the A-HB had been able for more than a decade to ensure the stability of the exchange rate of the crown, and also on the high volume of gold reserves which exceeded legal requirements. In his articles Mises rarely mentions the balance of payments, while the high foreign indebtedness of the monarchy does not appear to be a matter of serious concern.

The currency question had a strong political dimension because there was a political movement in Hungary to dissolve the joint institutions of the dual monarchy (foreign affairs, military, common currency) and to turn Hungary into a completely independent state. The advocates of independence considered legal payments in specie as a prerequisite for independence. The Hungarian Academy of Sciences committed the statistician Friedrich Fellner with a study on this issue. In his thoroughly researched investigation Fellner extensively dealt with the aspects to which Mises had devoted only little attention.

³⁶ Neurath 1910, p. 417

³⁷ Ibidem, p. 420

Fellner emphasized that it makes a difference whether in case of need the note issuing bank simply refuses to release gold in practice, or is forced to formally suspend gold payments³⁸. Hence, to make payments in specie obligatory, there must be maximum certainty about its sustainability. There should be no risk of outflow of gold. There will be no such outflow as long as the monarchy's balance of payments is in surplus³⁹. Hence, the existence of this surplus is the decisive factor for sustainability. Fellner fully acknowledged the benefits of the A-HB's policy of minimizing the volume of international gold transactions and its effects on the discount rate through active engagement in the market for bills of exchange, but nonetheless considers it of secondary importance. Likewise, the questions of silver coins and denomination of bank notes were of little relevance.

Fellner noted that the balance of commodity trade had been in surplus for many years. If it had turned into deficit in 1907⁴⁰, increasing amounts of remittances of Hungarian and Austrian emigrants to the USA and increasing receipts from tourism had mostly compensated for the trade deficit. Fellner also argued that the constancy of exchange rates was proof for a "favourable outcome of the balance of payments."

However, Fellner was aware of the fact that interest payments to foreign investors who held a major part of government bonds of Austria and Hungary and of other securities constituted "the most pressing burden for the monarchy's balance of payments". According to the statistics presented by Fellner, liabilities to foreign investors amounted to 10.500 million K (including 4.800 million K government bonds), whereas foreign assets owned by the monarchy's residents were only 700 million K. Fellner estimated the annual requirement for interest payments and repayment of the principal at 335 million K.

While Fellner admitted that this was a matter of concern, he soothes such worries by arguing that exchange rate stability was maintained by an "active balance of payments", and that it did not matter if the surplus was due to an "export of securities"⁴¹. Therefore, he saw no obstacles to making payment in specie a legal obligation, and expressed strong support for its introduction. As regards the benefits of this final step of the currency reform, his arguments are the same as those brought forward by Mises.

³⁸ Fellner 1911, p. 225.

³⁹ Fellner 1911, p. 203

⁴⁰ Ibidem, p. 222. Obviously Fellner used preliminary figures. Final results still show a surplus for 1907, but sharply increasing deficits thereafter.

⁴¹ Fellner, p. 229

Fellner's study deserves credit for pointing to the financial Achilles heel of the Habsburg monarchy. When a modern concept of balance of payment is applied, his positive conclusion appears somewhat lighthearted. There can be no doubt that the balance of payments problem of the monarchy was increasing after 1910. If trends had been allowed to continue, the crisis which Böhm-Bawerk predicted in a famous article⁴² would have become inevitable.

Estimates by economic historians indicate that the cumulative deficit of the balance of payments based on a flow concept (excluding Fellner's "export of securities") amounted to 1.250 million K during the last five years before World War I (1909-1913)⁴³. Also, rising prices constituted an additional risk for financial stability (see the next section) of Austria Hungary. What consequences this would have had belongs to "conjectural history". Even before Austria-Hungary's ultimatum and declaration of war to Serbia (28. July 1914), the gold standard had become history⁴⁴.

6. Mises on economic crisis in Austria before World War I

In two articles published in the *Archiv für Sozialwissenschaft und Sozialpolitik* in 1913 and 1915, and in his inaugural lecture at the University of Vienna Mises turned to the problem of inflation which had become a matter of economic as well as of political concern during the years before the Great War.

Prices had been declining after the crash of 1873 until 1892⁴⁵. During the decade that followed they remained roughly stable. After that, there was a continuous increase until the outbreak of the war. According to an ex-post constructed index of consumer prices, the increase amounted to 28,8 percent between 1902 and 1913⁴⁶. Comprehensive price statistics were not available at the time. If the phenomenon of inflation was observed in the other European countries as well, price increases for staple commodities such as wheat and meat in Vienna and Budapest considerably exceeded those registered in other places. On the part of the working class, the opinion prevailed that wages could hardly keep pace with price increases. Social policy experts expressed concern that the state was incapable of giving protection against rising prices⁴⁷. The chamber of commerce was upset about the rising number of strikes.

⁴² Böhm-Bawerk 1924/1914

⁴³ März/Socher 1973, p. 356f

⁴⁴ Pressburger 1966, p. 280f

⁴⁵ On the economic history of Austria in the period under consideration see Butschek 2011, p. 150ff

⁴⁶ Mülpeck/Sandgruber/Woitek 1979, p. 678f

⁴⁷ Richter 1912, p. 4

In his analysis of the problem, Mises draws a fundamental distinction between price increases for individual products, which have individual causes, and an increase of the general price level, whose causes must be sought in changes on the side of money. Assuming that the demand for money is unchanged, the increase of the price level is caused by an increase of the quantity of money, more specifically, because circulation of “notes and bank credit not covered by commodity money is steadily expanding.”⁴⁸ A general increase of prices affects different social groups unequally. In the sequence of price increases entrepreneurs used to have an advantage relative to workers and clerical employees. Resistance to the trend comes from those economic groups who suffer the more severe losses of real income. Resistance weakens if there is certainty that the burden of price increases can be passed on to other groups, or to the next stage in the production chain. “At present ... those people are at an advantage who understand better than others how to anticipate the rise in the prices of the goods and services they sell. These are not always the entrepreneurs. Alongside the best-organized cartels are the best-organized labour unions”. Put in modern terms, the process Mises describes is a wage-price spiral, which should be viewed as “symptom of buoyant activity, burgeoning development, and unceasing transformation in the nature of production and consumption.” As regards the causes on the side of money, “it would be desirable to put an end to the expansion of fiduciary media, whereas “as far as price increases have their cause in an increase in gold production, one must accept it as an unavoidable ill.”⁴⁹ They “do not warrant the concern they often arouse”. “In the light of this, a comprehensive policy to deal with rising prices that pays no attention to the basic cause for the decline of purchasing power of money is not worth implementing.”⁵⁰

If Mises’ lenient attitude displayed in these article appears irritating in the light of his later stance on the problem of inflation, it is more consistent with his principal positions of economic liberalism if his policy recommendations are seen in the context of the political debate of the time. For the socialists, rising prices functioned as an accelerator of revolution. For Otto Bauer, “revolution is the end of the fight against rising prices (*Teuerung*).”⁵¹ Under the impression of a violent demonstration in Vienna in September 1911, when several participants had been shot by the police, even bourgeois and conservative circles seriously

⁴⁸ Mises 1913b/2012, p. 160

⁴⁹ Mises 1913a/2012, p. 153ff

⁵⁰ Mises 1913b/2012, p. 166f

⁵¹ Bauer 1910, p. 96. Kautsky 1913 arrives at a similar conclusion.

considered the introduction of price controls by the state. This would have been “in insoluble contradiction with the individualistic principles of organizing the economy.”⁵² Hence, in Mises’ opinion to tolerate rising prices was by far the lesser evil.

Another matter of serious concern of economic policy was the rising deficit in the balance of commodity trade which could become a serious risk for the stability of the currency. In the above-mentioned series of articles Eugen von Böhm-Bawerk had explained the high trade deficit by an increase in the budget deficit due to excessive growth of state expenditure, with which the increase of revenues had not kept up. In Mises’ view, Böhm-Bawerk’s critical remarks were only a partial explanation, “they are not completely satisfactory in their interpretation of the causes of the liabilities in the trade balance.”⁵³ “However much the causes of the crisis may be found in overspending, a more fundamental reason is budgetary mismanagement in the private sector.” (p. 174) More important in Mises’ view was the increasing propensity of households towards debt-financed consumption expenditure. This practice was no more confined to the urban wealthy classes of population. The habit of deferring dates of payment had spread to the middle classes, especially civil servants and salaried employees. Under the pressure of competition, deference of payment had spread from the retail sector to the wholesale sector and further to industrial producers. “The 1912/13 crisis brought about the liquidation of the unsustainable borrowing system of previous years.” Instead of facilitating household indebtedness through its financial institutions, “the monarchy has to export goods in order to maintain equilibrium in the balance of payments without increasing foreign debt.” (p. 181)

7. Final remarks

The “gold standard mentality” as a fundamental characteristic of the Austrian School⁵⁴ originates from Carl Menger’s theory of money and its postulate of constancy of the value of money. Theoretically, one could think of a good whose intrinsic value can be kept constant in relation to the other goods “by appropriately regulating the quantity of that good which is brought to the market” – money. Menger goes on by stating that it is not impossible to “neutralize” (“aufzuheben”) the effects on the prices of goods “originating from an uninfluenced course of events on the side of money by deliberately influencing the circulating quantity of money, especially that of paper money”. In this way, a “means of circulation can

⁵² Mises 1913a, p.154

⁵³ Mises 1914-15/2012, p. 171

⁵⁴ Klausinger 2002

be established that exhibits a constancy of value in the desired sense.” However, Menger thought that “the dangers inherent in fluctuations of the prices of precious metals appear smaller than regulation of the exchange value of money by governments or political parties.”⁵⁵ Even though constancy cannot be expected as automatic result of a currency based on gold or silver, Menger pleads for a currency based on gold quasi as a second-best solution.

Mises abandoned Menger’s concept of “intrinsic” value of money⁵⁶, while keeping the fundamental distinction between changes in the objective value of money originating from the side of goods, and changes originating from the side of money. Attempts to stabilize the objective exchange value of money, no matter how desirable this goal would be, “have to be frustrated at the outset by the fact that both their goal and the road to it are obscured by the darkness that human knowledge will never be able to penetrate.” Hence, instead of pursuing the unrealizable ideal, “the state should at least refrain from exerting any sort of influence on the value of money. ... The significance of adherence to a metallic-money system lies in the freedom of the value from state influence that such a system guarantees.” Yet this guarantee is difficult to realize because “in the regulation of the issue of fiduciary media there is still another possibility of influencing the objective exchange value of money.”⁵⁷

In his essay of 1913 Mises only implicitly admitted that an increase in gold production was one of the causes of the observed increase of the general price level – and he thought that nothing should be done against this effect. The issue is not so clear with respect to the increase on fiduciary media originating from the banking system. Mises appears to be rather undecided between the pros and cons of a more strict regulation. In the end, he concluded that creation and expansion of fiduciary media should be left to itself, “one must merely avoid artificially expanding them.”⁵⁸ But he hardly gives any guidance what constitutes an “artificial expansion”. He gives only one example, that of the state-owned Austrian and Hungarian postal savings banks, which established a nation-wide service of postal money orders “that goes counter to all the teachings of economic theory.” (p. 160)

⁵⁵ Menger 1909, p. 86f

⁵⁶ Mises 1924, p. 104. In the English edition, this paragraph is only incompletely included in a footnote (Mises 1935, p.146).

⁵⁷ Mises 1935/1980, p. 269ff

⁵⁸ Mises 1913, p. 161f

In his *Theory of Money* Mises admits that “there is an irresolvable contradiction in the nature of fiduciary media”, but no general case can be made against their use or existence⁵⁹. In the first edition of this book, Mises objected to any attempt “to render the organization of the market any more perfect than it is.” Eventually, “the development of fiduciary media must necessarily lead to its own breakdown”⁶⁰. This could mean that Mises hoped that the process would check itself, and that thereafter the gold standard would re-emerge in its original form. Yet, after the experience of the catastrophic events following World War I Mises had lost this confidence, without being able to offer a concrete remedy: “It will be the task of the future to erect safeguards against the inflationary misuse of the monetary system by the government and against the extension of the circulation of fiduciary media by the banks.”⁶¹

⁵⁹ Ibidem, p. 358f

⁶⁰ Quoted in the English edition: Mises 1935/1980, p. 448.

⁶¹ Ibidem, p. 449

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