The Foreign Exchange Policy of the Austro-Hungarian Bank

The monetary system of the Austro-Hungarian monarchy has, during the last few years, aroused general interest in economic circles both at home and abroad. Theorists were first attracted to this question by Prof. G. F. Knapp’s excellent work, which found as many ardent admirers as opponents. In the recent bank enquête [inquiry] instituted by the German Government this subject was exhaustively treated. Under such circumstances, it may not be out of place to devote a little attention to this question, removing the numerous misconceptions both in the monarchy and abroad.

I

According to the law paper currency is still the standard currency, for the legal tender of the Austro-Hungarian Bank is inconvertible. In 1892, it is true, a number of legislative measures were taken in order to pave the way for a gold currency. One such measure obliges the said Bank to buy any quantity of gold offered to it at the rate of 3,280 kronen per 1 kilo pure gold (less 2 kronen for coining), thus hindering once and
for all any increase in the value of the Austro-Hungarian standard with respect to gold.

Since that time pure gold cannot be valued at less than k. 3,278 per kilo in Austria-Hungary, for should it decline the Bank must continue purchasing until the price rises again to par. A further measure, which was actually carried out, was the coining of gold, silver, nickel, and bronze coins. The old silver coins were withdrawn from the market, only the silver gulden remains, and even today it has unlimited legal tender quality. Since 1879 the silver gulden has been coined for account of the State only; in 1892 the coining was stopped, and at the moment (November, 1908) there are about 300 million kronen of such gulden in the Monarchy. This stock will very shortly be reduced by 28 million kronen, which will be recoined into 5-kronen pieces to meet the increasing demand for these coins. The 5-kronen pieces are, however, tokens; their coinage is limited, and no private person can be compelled to accept more than k. 250 in such coins as payment. Since the beginning of the Bank has been withdrawing the silver guldens and storing them in its cellars. These silver guldens will be gradually recoined into small coins, for, since wages have continually risen, the demand for fractional coins is especially great. Considering the unlimited legal tender quality of the silver gulden, the currency of Austria-Hungary must still be taken as a “limping standard,” even were the banknotes redeemable, just as the French currency must be described owing to the unlimited legal tender quality of the 5-franc piece.

In 1892 another very important measure was taken, viz., the redemption of the Government paper currency, i.e., legal tender notes issued by the Government. The Government raised a great loan and handed over the proceeds in gold to the Bank to enable it to redeem the Government paper currency for account of the State. This has actually been done, and today Government paper currency is a thing of the past.

The Bank, however, did not give gold for this Government paper currency, but banknotes, and in part silver guldens and silver fractional coins; the gold was retained as cover for the banknotes. In place of the not redeemable legal tender Government notes, not redeemable bank notes have been substituted. Whereas the old Government paper currency was not covered, the banknotes are partly covered by metal, bills, and loans, as in other Continental states.
To perfect the transition to a gold currency and thus finish the projected reform instituted in 1892, the Austro-Hungarian Bank ought to have been obliged to redeem its notes in gold when required. The law, however, has not yet prescribed such a procedure. Nevertheless, both the Government and the Bank have not lost sight of this point. The latter, especially, has done its utmost to augment continually its gold reserves. Besides the gold it possessed previous to 1892, and that already mentioned, which the Governments of both Austria and Hungary transferred for the redemption of the paper currency, it has also been able to purchase larger quantities of gold favored by the extremely good rates of exchange existing for a number of years. On the 7th of December 1908, the gold reserve of the Bank amounted to 1,135 million kronen, being only surpassed by the Bank of France and the Russian States Bank. But the Bank did not stop at the mere accumulation of gold, but endeavored to acquire a great number of bills payable in gold.

The Bank is obliged to cover its notes in circulation by at least 40 percent metal. As metallic cover the law recognizes gold coins, coined in Austria or Hungary, gold bullion and foreign gold coins, further Austrian and Hungarian silver guldens and fractional coins. For the so-called metallic cover of the notes in circulation are also recognized bills on foreign places, payable in gold within three months, and provided by at least two signatures of well-known endorsers, further foreign banknotes payable on demand in gold, the two together in the aggregate 60 million kronen. The other part of the cover has to be discounted bills and warrants, and loans against security. The Bank is permitted to include also in this part of the cover foreign gold bills and gold notes. As soon as the notes in circulation exceed the metal reserves, prescribed by law, by more than 400 million kronen, the Bank is obliged to pay a tax of 5 percent of the surplus. This latter clause is analogous to the German bank law.

Since 1899 the Bank is also entitled to have assets abroad and to draw checks, etc., on them.

Under such legal circumstances the Bank could very easily acquire great amounts of foreign bills and assets abroad. The gold lying in the Bank’s cellars does not bear any interest, but as soon as a part of it is exchanged for bills on Berlin or London—the Bank is allowed to do so to the extent mentioned above—it yields interest.
II

The Bank having in this manner increased its gold reserves and accumulated a great stock of foreign bills payable in gold, it took a further important step in 1896 to stabilize the foreign exchanges; it began to sell bills on foreign markets without reserve at a price which would be lower than the above gold point after the introduction of the gold currency. The sole aim of the Bank since then has always been to maintain a large stock of foreign assets payable at demand to enable it to satisfy any demand whatever that may be made, and in this respect has been very successful. It could sell bills on London or Berlin under such conditions that the exchange never rose above the par higher than it rises in countries with a perfect gold currency, and in which the bank-notes are redeemable at demand.

In August 1901, the Bank went still further, and began to issue gold coins of k. 20 and k. 10, and discounted bills and granted loans partly in gold instead of notes, and transferred gold to the Treasury for the salaries of their officials and other Government payments.

This change found but little sympathy among the public. For more than half a century only paper money circulated in both halves of the realm, and everybody got so accustomed to it that they were but little at home with the gold coins. Even today the public prefers banknotes to gold, and those gold coins issued soon find their way back into the Bank. The Bank, however, constantly sets them in circulation again, only to have them returned shortly afterwards. From August 1901 to the end of 1907 the bank gave out 1,616.4 million kronen, 1,381.7 of which returned by the 31st of December 1907, only 234.7 million kronen remaining out of the Bank. Of this latter amount only a part is in actual circulation, the rest being either in the State pay offices, at the private banks, or at the railway offices.

The state of things today is about as follows:

The Bank, it is true, is not compelled by the law to redeem its notes, but in fact it is always ready to do so. For home purposes gold is seldom, if ever, withdrawn, for—as mentioned—the public cannot break themselves of the use of banknotes and silver coins for small and moderate payments, and then, again, checks of the joint stock banks and the postal check service, as well as the clearing service of the Austro-Hungarian Bank, are all becoming more in vogue from year to year. As a rule the Bank is not called upon either to issue gold for payments
abroad; this is merely because it always sells foreign bills at such a price that it is cheaper to purchase and forward checks or bills than gold. The monarchy enjoys in this way every advantage of a gold currency, while it is able to carry on the circulation with a medium the least expensive.

It is clear to everybody that the Austrian monetary system is thus almost that ideal which David Ricardo once upheld. The Austrian system differs but in two points from that of the great master of political economy. One is of small importance. Ricardo wished to avoid the use of gold coinage as a medium of circulation, and, as he presumed that if everybody had the choice of using £1, £2, or £5 notes or gold, they would naturally prefer the latter, he saw no other way of preventing this than by subjecting the Bank to the delivery of uncoined gold or silver, at the Mint standard and price, in exchange for their notes instead of the delivery of guineas. With the above-described habits of the public here such a restriction is superfluous; even were the Bank compelled to exchange the notes for gold, people would prefer to use paper to gold, as is the case nowadays where the Bank willingly pays notes in gold.

The second difference is of more importance, still not one of principle. It is that the Bank keeps a great part of the cover for its notes not in actual gold but in foreign gold bills, and besides, to meet its other daily obligations, holds a further stock of foreign bills and other foreign assets at short notice; further, that the Bank sells such foreign bills to those wishing to make payments abroad, and consequently the bankers and merchants do not want gold, but bills and checks, to pay debts or to loan money abroad. Should the foreign bills or other assets abroad in possession of Austrians and Hungarians prove insufficient to cover the bills drawn on inland places and the checks in foreign hands, then the Bank exports gold on its own account. The gold is exported betimes, and bills acquired for it that the Bank then gives in exchange for its notes.

This policy of the Bank has been the cause that the rate of exchange in Austria-Hungary does not fluctuate as in other countries. This seems only natural, for today Austria-Hungary actually has a gold currency, although not de jure, because for more than twelve years the bank has voluntarily paid in gold or gold bills.

The Bank having succeeded for so many years always to keep a sufficient stock of gold and foreign assets to meet any possible calls made on it, it must be concluded that the Bank will also be able to pay its notes in gold on demand should the law prescribe it. Such a prescription would only alter the face of things in one respect, viz., that, whereas the Bank redeems its notes nowadays voluntarily, it would in future merely follow the demands of the law. But even then gold would not be taken by the public for home payments, though the Bank is empowered to issue small notes. Should the law prescribe payment in specie, the Bank can still buy foreign bills for its portfolio, and offer them at prices below the export prices, so that bills are used for sending money abroad instead of bullion or gold coin.

III

Nevertheless, numerous protests are made in Austria against the legal payment in gold for the following reasons, which must be considered. It is asserted that the discount rate of the Austro-Hungarian Bank has been lower and changed less than the foreign note banks. This is doubtless correct. The rate of discount of the Austro-Hungarian Bank was, as the following table shows, always lower during the last few years than that of the German Reichsbank, and often lower than that of the Bank of England, whereby we must not overlook the fact that the Bank of England also discounts below its official rate; the Austro-Hungarian and the German Reichsbank never do so.

The yearly average of the bank discount rates was:

<table>
<thead>
<tr>
<th>Year</th>
<th>Bank of England</th>
<th>German Reichsbank</th>
<th>Austro-Hungarian Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1903</td>
<td>3.75</td>
<td>3.84</td>
<td>3.50</td>
</tr>
<tr>
<td>1904</td>
<td>3.64</td>
<td>4.84</td>
<td>3.50</td>
</tr>
<tr>
<td>1905</td>
<td>3.01</td>
<td>3.82</td>
<td>3.70</td>
</tr>
<tr>
<td>1906</td>
<td>4.27</td>
<td>5.15</td>
<td>4.33</td>
</tr>
<tr>
<td>1907</td>
<td>4.93</td>
<td>6.03</td>
<td>4.89</td>
</tr>
</tbody>
</table>

The great stability of the discount rate of the Austro-Hungarian Bank is especially remarkable. It never rises as high as the German or

---

4. Nowadays kronen 20 notes may be given out at any time under the same conditions as k. 50, k. 100, and k. 1,000 notes; on the other hand, k. 10 notes may only be issued in the aggregate of 160 million kronen, and then if specially covered in full by gold.
English, nor falls so low. Even in the critical November days of 1907, when the Bank of England increased its rate to 7 percent, the German Reichsbank to 7.5 percent, the Austro-Hungarian Bank did not exceed 6 percent. On the other hand, its rate of interest has never fallen below 3.5 percent. From 1892 till 1907 included, the Bank of England altered its discount seventy-four times, the German Reichsbank fifty-seven, and the Austro-Hungarian Bank only twenty-one times.

The private discount rate, too, is not always higher than Berlin and London, often even lower. This was distinctly perceptible during the crises in the last quarter of 1907, when in November the private rate for three months’ bills, on an average, was Vienna 5.28 percent, Berlin 6.62 percent, and London 6.54 percent.

If the Austro-Hungarian Bank were legally constrained to redeem in gold, the opponents of such a measure maintain that the discount rate in Austria would always have to be higher than abroad, for the monarchy has foreign obligations, and must necessarily entice her foreign creditors by a higher rate to leave their money in Austria-Hungary. The suspension of the gold payments had the advantage of the Bank being empowered to pay in cash if it wishes, or, in other words, redeem its notes in gold or gold bills, but by no means compelled to do so. Importers wishing to pay for goods bought abroad, and those who have to pay the interest and amortization quota on foreign loans could always get the desired amounts from the Bank at any time in gold bills or checks. On the other hand, by refusing to sell bills when wanted merely for the purpose of sending capital abroad to profit by the higher rate of discount, the Bank would be protected against losing large sums of gold, and can easily maintain a lower rate than the foreign banks. Presuming the legal prescription of gold payments the Bank would be forced to participate in the international fight for gold like other banks, and as an only protection against attacks on its gold reserves raise the discount rate. In favor of industry and agriculture an increase of the interest on the home market must, however, be avoided at all costs.

This theory, which is supported by nearly every political party in Austria, is, however, entirely false.

First of all, it is not at all true that the Bank refuses to deliver bills and gold if it thinks they are for investments abroad. Far from upholding such a policy the Bank itself sends money abroad when the market

5. As such are considered first of all the State, the Crownlands, Corporations, then the large railway companies and mortgage banks.
appears to be favorable. If the momentary home demand is small and the gold reserves in the Bank fairly large, the Bank exchanges a part of its reserves for foreign bills in order to procure, in this way, interest on its capital, which otherwise would lie idle in its cellars. The moment greater demands are made on the Bank for bills for profiting by the difference in the discounts abroad, a corresponding rise in the rates of discount immediately takes place.\textsuperscript{6}

Did the Bank act otherwise, i.e., refuse to sell the bills and gold, as it is wrongly accused of sometimes doing, the exchange would immediately rise considerably. This is best seen if the present state of affairs is compared with those existing prior to the actual introduction of the gold payments in 1896. In 1893 a great tightness existed on the international money market owing to the Australian and North American crises. As at this period the Austro-Hungarian Bank declined to raise its rate of discount, the foreign holders of Austrian bills returned them to Vienna and demanded payment. Neither gold nor gold bills were to be had on the Austrian market and the Bank would not dispose of them either; the London bills on the Vienna Exchange rose to 127.65 guldens. This rate meant an agio of 6.3 percent, as compared to the par of 120.09 guldens fixed in 1892.

Later it also repeatedly happened that difficulties on the London and Berlin money markets caused an external drain in Austria. The Bank then immediately raised its rate of interest, and sold bills below the imaginary export point, as it would be after the redemption of gold payments. The same as note banks of other countries, it was able, in this way, to secure the stability of the Austro-Hungarian standard. Professor Knapp, therefore, is greatly mistaken in assuming an essential difference between the policy of the Austro-Hungarian Bank and that of other central note banks. In such cases the Bank of England redeems its notes in gold, the Austro-Hungarian Bank in gold bills, viz., gold in foreign hands. Yet the public who present their notes to the Bank are quite satisfied with this procedure, because they get bills at a price apparently so advantageous that they prefer to buy and forward Devisen (foreign bills) abroad instead of bullion or gold coins. To have the requisite stock of Devisen and able to meet any demand, the Bank sends gold abroad and procures bills in exchange. The whole difference, as compared to England and Germany, is that gold is not exported by

\textsuperscript{6} Bilinski, Über internationale Zahlungen, 1906, p. 3.
private businessmen but the Austro-Hungarian Bank itself. True, it cannot be denied that the large Austrian private banks sometimes do not export gold for the mere reason of fearing to offend the Bank who, otherwise, could possibly place difficulties in the rediscounting of their bills. In Germany, affairs are very similar but much more severe, and have absolutely no relation with the suspension of gold payments and the *Devisen* policy.

The cause of the comparatively low discount in Austria-Hungary must be sought in the bad state of business in Austria. The speculative spirit of the populace is almost entirely wanting, and the unfortunate state of politics is a stumbling block to active production. The former Minister of Trade, Dr. Baernreither, rightly declares that cheap money in Austria is by no means a sign of economic soundness, but, on the contrary, of stagnation and want of speculative spirit.

Another misleading assertion is that Austria-Hungary is burdened with obligations abroad, and consequently compelled to maintain a higher discount rate than other countries. For these obligations are only on the capital market, i.e., on the long loan market, and consequently the interest for rents and mortgages is higher than in Germany, not to speak of England. On the other hand, there are times on the money market, i.e., market for short loans, when the greatest Austrian foreign assets are met with but a trifling set-off on the part of the foreigners. This contrasts vividly with the state of affairs in Germany, whose holding of foreign stock may be estimated at 16 milliards of marks, even after deducting German stock in foreign hands, and nevertheless is regularly indebted abroad on the money market for big amounts. True, the foreign markets can get bills on Vienna by returning Austro-Hungarian stock, but the high classification of this paper hinders such an operation. The want of short foreign loans remarkably strengthens the Austrian money market in times of high discounts, for then the foreign markets are not able to withdraw money from it, but in the absence of claims due must accommodate themselves with loans on the Austrian money market.

IV

Professor Knapp regards the foreign exchange policy of the Austro-Hungarian Bank as diametrically opposite to the discount policy of other central note banks. He is of opinion that it is not right for two
States having the same metallic currency automatically to reestablish the par of the standard by the use of metal. The authorities ought to make it their special duty to maintain the standard value in international exchange. The English and German discount policy and the Austro-Hungarian “Devisen” policy could be taken as examples. In both cases some sacrifice has to be made. With the discount policy the sacrifice falls upon the business people, who are accustomed to discount bills and take Lombard loans\(^7\) from the Bank. The “Devisen” policy also demands some sacrifice; the Bank, it is true, bears it in this case, but only because it expects some compensation from the State.

The Bank employs a great part of its capital to purchase a number of bills on England, and regularly replaces them as they fall due. The Bank buys these bills at any price, and sometimes in the hopes of making a profit should the rate be favorable, but more often than not without any such prospects whatever, especially when the rate is unfavorable. Further, the Bank has decided to sell these bills at par as soon as the rate becomes unfavorable. With very rare exceptions, it loses on the bills. The exception is with bills bought at propitious times. By this intervention in the rates which otherwise are determined to suit personal interests, the par of exchange is reestablished, and a weighty administrative task performed that is well worth the sacrifice. The Bank may, therefore, justly expect the Treasury to recompense its losses.\(^8\)

It does not lie within our sphere to inquire how far Professor Knapp’s view that “an automatic reestablishment of foreign exchanges does not take place” is correct or not. Because this theory is closely connected with his general conception of money, it consequently can only be judged in connection with it. Such a task would surpass the limits of this article, which is devoted exclusively to the “Devisen” policy of the Austro-Hungarian Bank. But Knapp’s opinion of this policy must receive a little more attention.

First of all it must be shown that the “Devisen” policy claims no sacrifice from the Bank; on the contrary, it gives it enormous profits. The investment of a part of its assets in foreign bills and current accounts with foreign banks throws off a considerable profit in interests; also the fluctuations of the foreign exchanges, however small they may be, have a favorable influence on the Bank’s balance. For the Bank does not

---

7. “Lombard loans” are loans with securities pledged as collateral.
buy bills when they are high, but when low, and sells them with rising rates at a profit. It is not true either that the Bank’s foreign bills and checks are sold at par, but at the corresponding market price of the day. To prevent the rates rising above the ideal gold export point, the Bank endeavors to keep a plentiful stock of foreign bills at the disposal of the market. As soon as this stock gets low it is replenished. But the Bank never appears on the market as buyer when the price of foreign bills is high; this would be the worst step it possibly could take. The appearance of a new buyer would be more likely to drive prices up still higher. As already mentioned, the Bank—when the price of foreign bills is high—strengthens its stock by exporting gold, and thus places itself in a position to meet all and any demand that may be made.

The Bank is also able to drive the rates up if it buys foreign bills at low prices; but then its economic importance is entirely different. The demand for foreign bills being better distributed over the single days and weeks of the year, the fluctuations in the rates are more equalized; the average level can naturally not be affected in this manner.

The contrast drawn by Knapp between “foreign bill policy” and “discount policy” must also be described as equally incorrect. By its great stock of foreign bills and the clever use it makes of them, the Bank is not freed of its duty to prevent any temporary unfavorable situation of the balance of payments by raising the discount rate. To maintain the gold standard the stock of foreign bills merely acts as a strengthener of the metal reserves—an augmentation both the cheapest and the best. Were the Bank to realize the whole stock of foreign bills and augment the gold reserves with the proceeds, it could do the same economic service in future, true, less to the purpose and dearer, but with just as much security as nowadays. For the system of the Austro-Hungarian Bank is nothing else than a system of gold payments like England and Germany, yet better and more appropriate. The sole difference is the monopolization of the gold export by the Bank.

V

Consequently, it is utterly wrong to believe that the discount rate of the Bank and the market would be higher than at present after any legal prescription of gold payments. For more than twelve years the Bank

9. In 1907 the Bank’s profits of the foreign moneys and foreign bills was k. 5,732,672.
has upheld the policy of a gold-paying bank, and, therefore, any legal prescription can affect it but little. Even such law could not prevent it from always keeping in future a large stock of gold bills and gold assets abroad, and in this manner maintain a cheaper reserve than would be the case with the whole reserves lying idle in its cellars.

On the other hand, the monarchy will profit immensely by a legally prescribed gold payment, for its international credit, which it urgently needs for its enormous foreign debts, would considerably improve. For only the *de jure* gold payments would clearly convince everyone abroad that Austria-Hungary enjoys nowadays a perfectly regulated currency.