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War Finance (Austria-Hungary)

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The article presents a new estimate of the war costs and an overview of war finances in Austria and Hungary. Both countries of the Austro-Hungarian Monarchy were unprepared to meet growing war expenditures. Ordinary public revenues as a means of covering war costs were of limited significance, and war loans and the credits of the joint Central Bank became the main source to cover growing budget deficits. Following the summer of 1914, neither Austria nor Hungary could borrow abroad, with the exception of smaller credits that could be raised in Germany and the neutral countries.

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Introduction

The article gives an overview of former calculations of the war costs and presents a new estimate. It investigates the state of public finances and the most important means to meet growing war

expenditures, such as advances from the Central Bank, war loans and other domestic and foreign credits.

The significantly longer duration of the war demanded enormous human, material and financial sacrifices in and of the belligerent countries. The Dual Empire was unprepared to deal with the quickly growing expenditures and proved incapable of producing the required material and financial resources after the outbreak of hostilities. In the first year of the war, only 30 percent of real gross domestic product (GDP) were mobilized for the war effort, and the share had shrunk to 17 percent by 1917-1918. Thus the scale of mobilisation both in absolute and in relative terms was modest compared to that of major belligerent economies such as the United Kingdom or Germany.[1]

Although quantifying the costs of World War I is almost impossible, many scholars have been attempting to do so since 1918. Ernest Ludlow Bogart (1870-1958) published several estimations on war costs,[2] but his results were widely criticized on grounds of methodological and conceptual problems later on.[3] Based on comprehensive statistical data, Hungary's 1912-1917 Minister of Finance, János Teleszky (1868-1939), prepared a thorough study on state finances and war expenditures during the war in 1927.[4] Austrian war costs were summarized by the renowned statistician Wilhelm Winkler (1884-1984) in 1930. His slightly modified data were published in English in 1940.[5] The most recent study was written by Max-Stephan Schulze, who summed up the war costs of Austria-Hungary based on the estimations of Winkler published in 1940.[6]

War Costs

Based on the estimates by Winkler and Teleszky, Austria's war costs come to 65.1 billion crowns in current prices (15.4 billion crowns in 1913 prices), while Hungary's amount to 32.7 billion crowns in current prices (7.8 billion crowns in 1913 prices). Overall, the war costs of Austria-Hungary are estimated at 97.8 billion crowns in current prices, or 23.2 billion crowns in 1913 prices. In other words, the war consumed more than three times Austria-Hungary's GDP of the year 1913 (see table 1).

Year	Austria	Hungary	Austria-Hungary
1914/15	7,082.0	3,920.95	11,002.95
1915/16	11,434.3	6,476.16	17,910.46
1916/17	17,537.9	8,273.72	25,811.62
1917/18	20,980.3	9,056.14	30,036.44
1 July- 31 October 1918	8,021.3	5,000.77	13,022.07
Total	65,055.8	32,727.74	97,783.54
Proportion (Austria-Hungary)	66.53	33.47	100

GDP 1913			
Costs of war (current prices) in proportion to the GDP of 1913 (per cent)	17,373.90374	9,952.30329	27,326.2358
GDP 1914-1918 (1913 prices)	65,586.5	37,769.00	103,355.5
Costs of war (1913 prices)	15,448.7	7,771.81	23,220.51
Costs of war (1913 prices) in proportion to the GDP of 1913 (percent)	88.9	78.1	85.0
Costs of war (1913 prices) in proportion to the GDP of 1914–1918 (percent)	23.55	18.93	21.77

Table 1: Costs of World War I in the Austro-Hungarian Monarchy, current prices (million crowns)[7]

Financial sources	Austria	Hungary
Ordinary budget revenues	0	5.2
Central Bank loans	37.9	31.5
War loans	53.0	53.0
Loans of domestic commercial banks	3.9	5.2
Foreign loans	5.2	5.1
Total	100.0	100.0

Table 2: Financial sources of the war costs in Austria-Hungary, percent[8]

The Dual Monarchy spent disproportionately large amounts, burdening the Empire with hardly manageable debt and causing ravaging hyperinflation in both countries after the war. However, the amount and the relative scale of financial mobilization was comparatively smaller than in the bigger belligerent states, with the exception of Italy and, in relative terms, of Russia.[9]

Public Finances

None of the European countries were prepared for the enormous costs of the First World War. Since Austria-Hungary shared the belief that modern wars would not last long, both governments were reluctant to modify fiscal policies and raise ordinary revenues substantially during the first years of fighting.[10] What made Austrian and Hungarian state finances exceptional was how little of their ordinary revenues could cover war expenditures. Whereas the United Kingdom covered 28 percent, and the United States even a third of the war cost through tax revenues, other belligerents could hardly match such high proportions.[11] According to Teleszky, only 5,2 percent of Hungarian war expenditures were financed through ordinary budget revenues, while 94,8 percent were financed through government loans. 31,5 percent of the war cost was covered by loans from the Austro-Hungarian Bank, 53 percent by issuing war bonds, 5,2 percent by loans from the big Budapest

banks, and only 5,1 percent by foreign loans. According to my estimate, 53 percent of the war expenditures in Austria were financed by issuing war loans, and 37,9 percent through the loans of the Central Bank to the government. The big Vienna banks loaned 3,9 percent of the war costs, and the remaining 5,2 percent were met through foreign loans.[12] In the case of Austria, the total government debt accumulated during the war amounted to 68.5 billion crowns which exceeded the total sum of war costs. It goes to show that tax and non-tax revenues of the Vienna government were not sufficient to cover even civilian expenditures.[13]

Until the end of 1915, the Austrian government held the opinion that the country's population, already affected by the hardships of the war, would be unable to bear an additional financial burden.[14] The Treasury in Vienna only started reconsidering its revenue policy as the financial situation worsened. In April 1916, a war profits tax with progressive rates based on the German model was introduced. However, it did not yield much revenue, as the new law retained many loopholes for tax evasion.[15] From autumn 1916, measures were taken to cover a larger share of expenditures through tax and non-tax revenue. Surtaxes were levied on already existing direct taxes such as income tax, profit tax of joint stock companies and land tax. The prices of tobacco products were repeatedly increased, and consumption taxes on spirits and beer were raised. In spite of the drastic increase, consumption taxes did not generate much income due to diminishing domestic consumption. Gambling and playing the lottery were also taxed harder, and the taxation of match, flint and steel was introduced as a new type of state revenue. Tax rates were raised again in 1917 and 1918. In January 1918, taxes on wine and sugar consumption, general tax on earned income, land tax and surtaxes on direct taxes were increased. Following the German sample, coal tax was also introduced.[16] Still, all these efforts to increase the revenue did not prove effective. Austria's financial situation worsened continuously, and by 1918, the government was accumulating dramatically growing debts. Revenues from the state monopolies tobacco, salt and saccharin proved equally insufficient in both Hungary and Austria.[17]

The Austro-Hungarian Monarchy started the war without adequate financial preparations.[18] The economic situation was not helped by the fact that no new budget estimates were introduced in either the Austrian or the Hungarian parliament until late 1917. Since the last ordinary estimates had been accepted in Austria in 1910, state finances had been regulated only through decrees (*Budgetprovisorien*) until 1916-1917, as the *Reichsrat* had been put off in March 1914 and was dissolved in July that same year. Paragraph 14 of the 1867 constitution empowered the government to regulate important questions requiring parliamentary approval when the Reichstag was not in session. The Vienna parliament reassembled in May 1917, when the first new budget since the outbreak of the war was introduced.

In Hungary, too, no ordinary estimates were accepted during the war years, but the validity of the act regulating state finances from 1914-1915 was repeatedly extended by bills of authorization. Paragraphs 16 and 17 of the Bill LXIII from 1912, which enacted the state of emergency in case of

war, granted the government full power to take all measures necessary to cover war costs. Although the Budapest parliament was in session during the war, conflicts between political groups made it difficult to fund war expenditures with ordinary budget revenues. Proposals for tax increases or attempts aimed at the introduction of new taxes were met with strong opposition already before the war broke out.[19] The duration of the war, as well as the quickly growing military expenditures, compelled the Treasury to enlarge budget revenues. Income tax, which had existed in Austria since 1896, was introduced in January 1915, while a property tax and a war profits tax were accepted by the Hungarian parliament in 1916. However, none of the newly introduced taxes yielded adequate revenue, as the income tax rates, for example, were only modestly progressive and applied merely to exceptionally high incomes.[20] Inefficient administrative procedures and shortage in qualified personal contributed to delayed tax collection. Maintaining the social consensus combined with the need to continue their involvement in the war forced both governments to find other ways of financing the war.

Government Debts

Since common public revenues as a way to defray war expenditures were of limited significance in the Austro-Hungarian Monarchy, these costs had to be covered by loans. After the outbreak of the First World War, foreign credits ceased to serve their prior, long-term investment purposes for the governments, but instead covered current public expenditures. The line-up of creditors had substantially changed as well. Money holders such as the Central Bank and the population, which had not given the government credit before, became the most important lenders, replacing former foreign creditors for many years to come. European financial markets discontinued capital exports from summer 1914. From November and December of the same year, a further embargo prohibited all financial transactions between citizens of opposing belligerent nations thus restricting capital flows to countries of the same military alliance. As a consequence, neither Austria nor Hungary could borrow abroad following the summer of 1914. Instead, loans were to be obtained principally from domestic funds such as the big commercial banks, the Central Bank or the population, while only a smaller amount of capital was to be raised in Germany and in the neutral countries.

Central Bank Credits

From summer 1914, the credits of the Austro-Hungarian Bank became the main source with which to cover the growing budget deficits. The first loan agreement was signed 14 August 1914, followed by many others. The governments shared the amount of loans in accordance with their respective agreed-upon quota to the joint affairs, which were at 63,6 percent for Austria, and at 36,4 percent for Hungary at the time. The legal background for central bank credits was created on 17 August 1914 by abolishing the Bank's Statute, forbidding the Bank to supply governments with funds.[21] Elimination of the Statute repealed the Bank's former relative autonomy and made her defenceless against the governments' credit demands. The 40 percent cover ratio of bank notes was also

suspended, along with the duty to maintain the value of the currency. In consequence, the monetary policy of the Central Bank turned out to be one of the major factors that caused the depreciation of the crown.

During the first year of the war, the Austro-Hungarian Bank supplied separate credits for the respective governments. From mid-1915, a regular credit scheme was accepted, in the scope of which loans of 1.5 billion crowns were given to the governments against debentures which could be obtained quickly and without previous negotiations. This agreement introduced the system of automatic deficit financing by the Central Bank.[22] Loans as high as 1.5 billion crowns were granted on twenty-one occasions from 1915-1918.[23] By 26 October 1918, Austria owed 25.1 billion crowns and Hungary 9.9 billion crown to the Central Bank. With the exception of Czechoslovakia, the consequence of the generous credit policy turned out to be devastating hyperinflation in the successor states of the Austro-Hungarian Monarchy in the early 1920s.

War Loans

War loans were the most common alternative way of financing war expenditures. Bonds were issued on eight occasions during the war simultaneously in Austria and Hungary. The first bond was issued 16-24 November 1914. It was a huge success that exceeded all expectations and provided the Austrian Treasury with 2.2 billion crowns, and the Hungarian Treasury with 1.2 billion crowns. The unexpected success had many reasons. Both Treasuries wanted to increase the popularity of war bonds through favourable terms aimed directly at domestic investors. The bonds were duty and tax-free, and so as to attract smaller savings, bonds in smaller denominations were also issued.[24] The net yields of the bonds exceeded the rates of interest common before the war. The Austro-Hungarian Bank, the war loan offices set up in Vienna and Budapest, and many commercial banks and savings banks gave collateral credits to bond holders under favourable conditions in order to increase the amounts of subscriptions.[25] War loan propaganda organized and controlled by the Treasuries in Vienna and Budapest proved to be effective as well. The Austrian and the Hungarian government wanted to create a new investment form that would be attractive to small and big investors alike, even for those who had felt reluctant towards public bonds before the war. Journals and newspapers were important propaganda tools, but it was a collaborative effort carried by ecclesiastic and secular celebrities, leaders of the business federations and of civil organisations, politicians and actresses that popularized the bonds. While the very first subscriber had always been the Emperor, public servants and even soldiers on the front were also expected to subscribe. Further research is required on the social, as well as the national composition of the private bond holders, and on the structure of the institutional investors (banks, industrial and commercial enterprises, insurance companies, pension funds).

Bringing 18.6 billion crowns to Hungary and 35.1 billion crowns to Austria, the eight issues proved to be the most important source of revenue for both governments. As the war progressed, the enthusiasm for war loans was diminished with growing war exhaustion. The yields that had once

seemed attractive turned to be worthless in the face of accelerating post-war inflation. Declining eagerness was reflected in the ever longer durations of subscription periods. While the first one took only eight days, the second, third and fourth had gone up to thirty days, and the last four lasted forty-six days on average. The subscribed amounts (in real values) declined as well (partly caused by accelerating inflation); in Austria, the last subscription yielded only a fourth of the first one in 1913 values. While the amounts fluctuated more in Hungary, the tendency was declining as well (see graph 1).

Graph 1: Results of war loan issues in Austria-Hungary, 1914-1918, million crowns[26]

Domestic and Foreign Credits

Although the concept of war bonds turned out to be a success, their actual amount proved insufficient to cover growing war expenditures, and missing funds had to be supplied by the major Vienna and Budapest banks. From mid-1915, Austrian commercial banks provided numerous loans for the Austrian Treasury. According to Haider Shnawa, the sum total supplied by these banks was 2.6 billion crowns. In Hungary, too, the major Budapest banks had to help the Hungarian government sustain war efforts and loaned 1.7 billion crowns over the war years. [27]

While the Allies could access a sophisticated, flexible, domestic and foreign capital market, Austria-Hungary was incapable of attracting significant amounts of foreign capital from 1914-1918.[28] Foreign loans during these years were taken up to finance the most essential imports (mainly foodstuffs) and helped cover the growing deficit of the balance of trade. Foreign capital was also needed to protect the Austro-Hungarian crown's diminishing exchange rate on the European neutral states' financial markets.[29] The most important creditor was Germany. Both Austria and Hungary signed a contract with a syndicate made up of the Berlin banking houses *Disconto Gesellschaft, S. Bleichröder* and *Mendelssohn & Co*. on a Treasury bill loan which was extended many times during the war. Germany granted other smaller credits to Austria-Hungary to finance German imports.[30] Although these credits were given on favourable terms, they were not even sufficient to cover German imports surplus over the course of these years. Germany’s reluctance to give Austria and Hungary more loans was cause for some serious conflicts between the military allies.

On account of the increasing shortages in foreign exchange, the foreign exchange control had to be introduced. On 1 February 1916, the *Devisenzentrale* was set up simultaneously in Vienna and Budapest. However, it was not able to guarantee an adequate amount of foreign exchanges, wherefore the Austro-Hungarian Bank was forced to sacrifice her own gold and foreign exchange reserves and borrow abroad.[31] During the war, the states of the Dual Monarchy took up minor loans in the Netherlands, Switzerland and Denmark to cover the purchase of basic necessities such as foodstuffs and raw materials. In 1917, a credit granted by Sweden and Denmark was used to support Austrian and Hungarian prisoners of war in Russia by buying medicine and food and having

it sent to them. Overall though, these loans were only of minor significance. Austria took up 3.39 billion crowns in foreign loans during the war, 93.5 percent of which was granted by Germany. Hungary's share of the foreign credits amounted to a mere 1,66 billion crowns.[32]

Conclusion

Although Austria-Hungary was unprepared to meet the enormous war costs and lacked adequate financial resources, monetary and fiscal authorities managed to find ways to cover growing expenditures to sustain long lasting war efforts. Ordinary public incomes proved to be of limited significance, as internal political conflicts made the increase of tax and non-tax revenues practically impossible. Neither Austria nor Hungary were able to borrow significant amounts of foreign capital over the years. From mid-1914, war loans and the credits of the joint Central Bank was the main source to cover the growing budget deficits. From July 1916, Vienna began accumulating bigger deficits and relied increasingly on the Central Bank's loans than Budapest, putting Austrian state finances in a much worse position than its Hungarian equivalent. The article offers a new estimate of war costs for both countries of the Austro-Hungarian Monarchy and presents both Austrian and Hungarian war finances simultaneously for the first time.

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Notes

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