Chapter 8

The stabilization in Austria and Hungary: the League schemes

8.1) Introduction

The end of the hyperinflations involved a number of factors and mechanisms that have been treated under different headings throughout this work. We provided an analytical discussion and the historical account of the dissemination of indexation and dollarization respectively in Chapters 2 and 7; we suggested that in a highly indexed/dollarized economy the coordination problems that we studied in Chapter 3 are mostly solved as the fluctuations of one single price, the exchange rate , become the determining factor for all nominal price and wage readjustments in the economy . It was suggested in Chapters 4 and 8 that inflationary finance was not an active determinant of inflation during these episodes and that the driving forces of the process should be found outside the monetary sphere. In Chapter 5 we argued that the determining factors of the hyperinflations could be associated with inconsistencies between real wage targets and external balance, so that the stabilization would depend basically on a major permanent improvement of these countries payments positions. Chapter 6 provided evidence on the magnitude of both the external imbalances and on the wage problem and suggested that the incompatibility was mostly "solved" or evaded by reopening international capital markets to these countries and the spurt of international lending of the second half of the 1920s.

The role of this and the next two chapters is to assemble these several pieces and compose the individual pictures of the final act of the stabilization. The basic short term problem involved was one of fixing the exchange rates, but more fundamentally a more "permanent" solution for the external constraint, or for the wage problem, should be found. This chapter examines the solutions given to the Austrian and Hungarian problems; the distinctive feature of this solution was a large external loan under very strict conditionality and the enforcement of policies and procedures in close accordance with the resolutions of Brussels and Genoa. In both countries foreign financial help was seen by nationals from the very beginning as a sine qua non for the stabilization and a basic objective of nearly all finance ministers during the inflation period. The League loans and the capital inflows that followed would play the role of the "permanent" improvements in these countries payments positions, in the terminology of Chapter 5, necessary to reconcile external balance and wage demands. A high price would have to be paid for that, not only because the conditions to which the loans were made contingent were as nearly humiliating as a customs house occupation, but also because the League schemes failed to address the fundamental structural problems these countries faced. Non-adjustment under acceptable levels of wages and unemployment could only be sustained while borrowing abroad was available, and as observed in Chapter 2, whether these economies longer run problems would be addressed was a matter of the allocation of foreign funds to uses compatible with external balance on an intertemporal sense. By leaving the problem to be solved by "market forces", and by maintaining a strict compliance to "sound finance" there resulted that these loans were mostly put to "unproductive" uses. But in any event these problems laid beyond the policy horizon contemplated by the League. Their focus was strictly financial and a short run one; there was much to be done in this regard and this chapter is mostly devoted to see how it was done. This chapter is very simply organized, the next section examines the Austrian stabilization, section 8.3 treats the Hungarian case and the final section summarizes some of the main lessons of the two episodes.

8.2) The development of an international action: Austria

It is not easy to overstate the importance of foreign financial help for the Austrian stabilization; contemporary Austrian opinion seemed unanimous on its absolute necessity and the behavior of the economic authorities appeared to be governed by little else. No wholehearted stabilization effort was attempted before foreign credits were made available through the League, but it is also true that the domestic political stalemate posed on overwhelming obstacle to any stabilization initiative. It is interesting to examine the alternatives discussed domestically. On one side, the socialists and their unions sponsored a strong drive towards the pre-war levels of wages, and at the same time they were committed with the Anschluss idea or with the notion that the country was not "viable" with its new frontiers. Their anti-inflation program laid strong emphasis on budgetary reform and on a somewhat confiscatory capital levy, but also observed that an external loan was an indispensable part of the program[1].

More to the right of the spectrum the idea of the indispensability of an external loan was even stronger. Some business circles expected to connect the need of foreign currency for stabilization purposes to the country's need to undertake investment programs in areas such as energy, food and transport, which were identified as bottlenecks generated by dismemberment. This was, for instance, the position of the chairman of the Reparations Commission William Goode, and it is significant that these proposals were supported to a significant extent by the left[2]. Further to the right lay the conservative "sound money" proposals lined up with the Brussels Resolutions and the international financial establishment. The main item of this program was an independent central bank that would become the vehicle for foreign financial help through its subscription to be made especially abroad and through the continued support of the larger central banks[3]. The basic dilemma was therefore not around a large foreign loan and the inevitable loss of sovereignity it would entail; as put by an historian, "the disagreement between the opposition and the government, then, was not really one between self-help and foreign aid, between Austrian independence and dependence upon international capitalism, but between two kinds of dependence. Austria faced the choice between Anschluss with an old friend and ally with an insolvent economy - Germany - and dependence upon her former enemies - the Western Powers - whose economy could be very helpful "[4].

The ubiquitous emphasis on the foreign loan was an eloquent indication of the very precarious international position of Austria; this and the decisive pursuit of real wage levels of 1914 seem to conform very well with the picture presented in Chapter 5 of inflation as a product of the incompatibility between external balance and a "fair", at least as seen by workers, income distribution. Real wages could not really be detained from their drive towards 1914 levels, not only because the young Austrian democracy could not afford it, but also because wages have been dangerously close to what was seen as the

[1] As demonstrated in Otto Bauer's financial plan of October 1921. Cf. E. Marz (1984) p. 417.
[2] E. Marz (1948) pp. 553-554.
[3] The main proponents were the foreign banks established in Vienna and their international sponsor was the influential president of the Dutch Central Bank Gehard Vissering. Cf. *ibid*. pp. 555-556.
[4] K. von Klemperer (1972) pp. 183-184.

subsistence levels. In these conditions the only possible solution for the Austria problem was, therefore, a complete redefinition of the country's international position so as to make compatible the wage demands and external balance under fixed exchange rates. An external loan was, in this sense, an essential first step not only to effect the stabilization but also to reopen international capital markets to Austria and to assure a steady flow of foreign capital into the country. More fundamental adjustments, however, would depend on the country being able to address its "structural" problems in the food, energy and transportation sectors and its capacity to direct international investment to these areas.

The evolution of the Austrian inflation is by and large governed by the successive frustrations collected in the attempts to secure foreign financial help. The first important attempt in this direction was the request by the Austrian government and then the establishment in February 1920 of an Austrian section of the Reparations Commission. Since it was known that this new body "would be commissioned to elaborate a detailed scheme of reconstruction"[5], the Reparations commissioner was received in Vienna with "hopeful curiosity instead of misgivings ... for it had become clear, in the meantime, that the reparation clauses of the Peace Treaty were unenforceable"[6]. Improved "expectations" on forthcoming aid and government intervention on the foreign exchange market not only halted currency depreciation but appreciated the crown from 280 crowns per dollar in February 1920 to 165 by the end of July. During this same period wage driven prices rose about 28% turning increasingly difficult for the government to sustain the peg. Since foreign financial help was not to be found Austrians faced the prospects of an "unaided" stabilization; the government coalition seemed unable to agree on a stabilization program and as the socialists left the cabinet the peg was suspended and the crown reached 660 to the dollar at the end of the year.

Early in 1921 more concrete steps were taken towards foreign help; William Goode proposed the floatation of a loan as part of a stabilization program known as the "Goode Scheme". It prescribed a loan of 250 million dollars, which was about twice the real value of the money supply at this point, to be deployed in tiding the country over during fiscal reforms but especially in investment programs in areas such as water power

[5] J. van Walré de Bordes(1924) p. 140 and also LN(1926a) p. 11.
[6] E. Marz(1982) p. 425.

and modernization of agriculture. An important indication of the position of creditors countries towards the Austrian problem is provided by the fact that the project was examined by the Supreme Allied Concil in January of 1921, and refused "in part because of the absence of positive garantees regarding the deployment of the proceeds of the loan...and in part because of the dimensions of the sum involved in a moment when the Allied Powers were themselves experiencing the world economic crisis [of 1920-21]"[7].

The "Goode scheme" appeared to be distant from the Brussels resolutions on which the Allies seemed to rely so much to orient their actions towards the international stabilization problem. Possibly in view of this the next Austrian move in March of 1921 was a formal inquiry into the possibility of using the Ter Meulen credits, proposed in the Brussells Conference, for longer term maturities so as to allow the floatation of a stabilization loan[8]. The proposal was well received and the Allied Powers declared they would renouce temporarily from their claims granted by the Peace Treaties provided that Austria complied with the terms established by the Provisional Economic and Financial Committee of the League of Nations, which by the time was trying to implement the Ter Meulen credits[9].

The League formed a mission of experts that devised a "comprehensive" plan based on whose adoption a large stabilization loan, as well as advances against Ter Meulen bonds, would be made contingent to. The plan followed very closely the Brussels resolutions in its emphasis on fiscal matters and its absolute disregard for the investment endevors proposed in the Goode Scheme. It was proposed that a new bank of issue entirely independent from the government would be formed and half of which would be

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[7] M. Pillet(1928) p.62. An alternative known as the "Loucheur Scheme" was also rejected with much less consideration L. Pasvolski(1928) pp.112-113 and J. Van Walré de Bordes (1924) pp. 140-14.

[8] The Ter Meulen credits had been proposed and accepted in the Brussels Conference by the distinguished Amsterdam banker C. E. Ter Meulen. It envisaged mostly commercial credits (of maturities later determined to be no greater than five years) as Brussels concern was with "essential imports", and it should be incorporated into an International Credit Scheme to be managed by a special commission of the League. The scheme eventually approved by the League Concil in December of 1920 provided for the issue of bonds against some asset whose revenues would be administered by this League commission, which would later become the influential Financial Committee who sponsored all the League stabilization programs. See LN(1930a) annex and (1945) p.13 *passim.*

[9] See LN(1945) pp.14-15.

subscribed abroad[10]. Monetary expansion against government's paper would be immediately stopped while strict austerity measures would be imposed and a domestic forced loan would allow for financing the deficits to occur until the budget was balanced . In order to manage the foreign credits, the revenues allotted as garantees, and the execution of the program a Commission of Control would be formed and it would be composed of seven members, four of which chosen by the Financial Committee and the remaining three by the Austrian government.

A clear emphasis was given to the fact that the plan was a product of the expert advice of an international organization and that the implied sacrifices would be inevitable or that the League was imposing measures that Austrians would have to take anyway. This was certainly a very significant improvement in the selling strategy of high conditionality loans on both ends of the bargain. All three Austrian parties reacted sympathetically to the plan, which allowed the government and the League to go ahead with the necessary preparations. On the other hand the "international" character given to the problem made possible to the League to attempt to raise the liens over Austrian property established by the Peace Treaties. This, however, resulted a long and painful process[11] during which the Austrian economic situation suffered a continuous deterioration: prices rose 455% during the second semester of 1921 and at the end of the year the exchange rate was about to reach 10.000 crowns to the dollar.

Riots and disorders seemed to signal that the collapse of the young republic could be very close; the Austrian problem acquired a truly international political dimension as it started to look like a legitimate threat to the stability of Central Europe. Ad-hoc credits were obtained from the Central banks of Czechoslovakia, Britain and France, to give Austria some breathing space until the Genoa conference; the credits were quickly dissipated, however, and the Conference produced no new development to the Austrian

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[10] The "Experts" Delegation further proposed the creation of a new gold currency, the Austrian Franc, which was not considered necessary by the Financial Committee which emphazised strongly that "prominence should ... be given to a statement that the Bank will make it its first duty to support, by all means in its power, the exchange value of the krone or of any new unit, and that it is intented at the earliest possible date to substitute the existing discredited notes for a completely new currency with a definite value". Cf. LN(1921) p. 8.

[11] It involved no less than 18 countries, including those involved in the granting of relief credits. In many of these, as for example in the US, these matters had to become legislation.

problem. A new conservative cabinet was appointed in the end of May and attempted unsuccessfully to implement the League's plan but based on a domestic subscription of a new bank of issue[12]. Chancellor Seipel then made a desperate appeal to the Allies from whom he heard that the matter should be resolved by the League, which should be able to propose "a program of reconstruction, containing definite garantees that further subscriptions would produce substancial improvement and not to be thrown away like those made in the past"[13].

The prospects of a significant loss of sovereignity implied in the adoption of the League plan induced the Austrian chancellor to flirt with other alternatives. Seipel embarked on a trip to Germany, Italy and Czechoslovakia and made no secret that "if need be we shall sacrifice our economic independence and even our sovereignity , by means of an economic or even a political merger with one of our neighbors, in fact with the highest bidder"[14]. Although Pan-German projects could hardly succeed at this point, a revival of the Anschluss issue could affect public opinion vary strongly[15]. Little could be expected from Prague which stood as one of the pillars of the European *status-quo*[16], but in Italy Seipel proposed a customs union which though not regarded as an "ideal solution", according to an Austrian official, it "would have safeguarded our existence and forestalled foreign intervention"[17]. The very fundamental result of the trip, that was termed by an historian a "macheavellian gamble"[18], was to force the Allies into the acceptance of the League's plan. Shortly after on September 6th Seipel went to Geneva to state officially before an enthusiastic League assembly that Austria accepted the League's intervention.

The basic plan was the same offered by the experts in 1921 with some slight differences. The reconstruction loan would be expressly earmarked to cover the transitory budget deficits on which it would be helped by a domestic issue of indexed bonds and a

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[12] This failure has been attributed to the uncooperative standing of the foreign banks established in Vienna. Cf. E. Marz (1984) pp. 485.

[13] LN(1926a) p.15. The last sentence obviously refers to the British credit given in the spring of 1922.

[14] L. Aubert(1925) p. 41.

[15] Edward Marz saw the German trip much as an act of "diplomatic cortesy". Cf. E. Marz (1948) pp. 587-588.

[16] *Ibid* p. 586.

[17] *Ibid* p. 587ff.

[18] E. Marz (1948) p. 588.

short-term advance of £ 3.5 million. A Commissioner-General, instead of a Commission of Control, would be appointed to reside in Vienna to manage personally the proceeds of the loan, to accompany the fiscal measures previously agreed by the government, and to report on a monthly basis to a Committee of Control of the Garanteeing Governments. The Commissioner had powers to impose new measures and to halt any drawings from the loan proceeds if dissatisfied with the workings of the program. Nothing was established regarding foreign participation in the new bank of issue, though it was known to be very substantial: at least and an "advisor-director" would be appointed by the Commissioner-General to have veto powers over the board's decisions[19]. The main lines of the plan[20] would be fit into three protocols which would be ceremoniously signed in Geneva and shortly after ratified by the Austrian Parliament.

Table 8-1
Austria: International reserves, real value of the money supply and cover ratio
August 1922 to July 1923
(thousand dollars)

Date		Money Supply[1]	Int'l Reserves[2]	Cover Ratio
1922-	Aug.(1st)	29.877	6.637	22.2%
	Aug.(31st)	23.008	3.604	15.7%
	Sep.(30th)	31.887	5.179	16.2%
	Oct.(31st)	41.593	3.804	9.2%
	Nov.(18th)	44.721	3.517	7.8%
	Nov.(30th)	47.849	8.134	17.0%
	Dec.(31st)	57.122	18.986	33.2%
1923-	Jan.(31st)	57.542	15.494	26.9%
	Feb.(28th)	58.912	15.568	26.4%
	Mar.(31st)	62.428	19.908	38.9%
	Apr.(30th)	64.083	21.183	33.0%
	May(31st)	67.719	24.570	36.3%
	Jun.(30th)	76.057	36.477	48.0%
	Jul.(31st)	79.578	42.280	53.1%

SOURCES and OBSERVATIONS: (1) Computed by J. P. Young(1925) vol. II p. 296. (2) Computed from J. Van Walré de Bordes(1924) pp.206-207.

As it became known that negotiations had been concluded the recently recreated exchange controls institute, the Divisenzentrale, was able to stabilize the exchange rate in

[19] And a mandate to last for three years after the termination of the Commissioner-General's functions.

the end of August[21]. The floatation of the loans, however was still a long way ahead; a League official described this period as "a time of great anxiety", for although the depreciation was arrested "the scheme only existed on paper, and until these credits become available and the new bank of issue was founded, there was no real support to prevent a further decline; and the external loan was still a distant and doubtful prospect"[22].

The stock of international reserves held in the end of August could not afford much delays in the implementation of the League scheme as it can be seen in Table 8-1. The actual cover ratio was 16% in August/September but the average stock of reserves at this point barely reached 4% of the "normal" stable prices demand for money, as measured, for instance, by the average money supply in the first quarter of 1925[23]. With the end of the hyperinflation the demand for money jumped to its "stable-prices" level in response to which the money supply grew approximately 247% from August to December. The cover ratio decreased from August until November when an increase in reserves was produced by the domestic floatation of an issue of indexed bonds amounting to approximately US$ 12.0 million subscribed in hard currency[24]. Exchange controls were exceptionally tight during this critical period and interest rates were very high at least until January 1922[25]. But in January "public opinion in Vienna began to relapse into pessimism ... the floating of the first foreign loan - the short term loan - was delayed longer than had been expected ... [and] the public became seriously alarmed and began once more to question whether foreign aid would really be forthcoming"[26]. Finally in February the short term loan was floated which assured the continuation of the peg until

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[20] Including a joint declaration assuring the "political independence, territorial integrity and economic sovereignity of Austria". Cf. LN (1926a) p. 137.

[21] According to a contemporary opinion "the tidings from Geneva brought the turn of the tide. Though it was uncertain what would emerge from the deliberations of the Concil of the League, everything seemed to show that this time the Austrian problem was receiving serious treatment. The foreign exchange speculators remained for a while 'in the fence' waiting to see what would be the outcome. In this circumstances the Divisenzentrale was at last able to stabilize the rates of exchange". Cf. J. Van Walré de Bordes(1924) p. 203.

[22] LN (1926a) p. 30.

[23] Approximately US$ 110 million.

[24] Or 60 million gold crowns. Cf. E. Marz (1984) p. 504. Deducting this loan's contribution the cover ratio in December would be only 12%.

[25] There are accounts of call money rates as high as 5% weekly in the end of 1922. Cf. *ibid*. p. 536 . With the opening of the new bank of issue in January a discount rate of 9% was implemented apparently without credit rationing. Cf. LN (1926a) pp. 95-96 *passim* and W. Layton & C. Rist (1925) pp. 122-124.

the large loan was issued in June.

Table 8-2
Austria: real wages and real exchange rates
(1913=100)

	Date	Real Wages[1]	Real Ex. Rates[2]
1922-	June	73.1	81
	July	77.0	93
	August	80.9	102
	September	84.8	118
	October	89.3	118
	November	93.8	112
	December	98.3	113
1923-	January	94.9	120
	February	91.4	128
	March	88.3	131
	April	89.1	132
	May	91.1	128

SOURCES: (1)Index of wages computed from ILO(1925) p. 85-86. (2)Real exchange rates are wholesale prices in terms of gold from LN(1926a) p. 88.

The net proceeds of the reconstruction loan reached 611 million gold marks or approximately 124 million dollars; deducting the amortization of past credits there remained a sum in the vicinity of 100 million dollars[27]. The real value of the money supply surpassed this value only in February of 1924 or nearly an year and a half after the stabilization; the loan was therefore nearly enough to convert the whole stable-prices-money-supply into gold. The loan was indeed a solution for the Austrian problem but not necessarily a long term solution. It certainly improved Austrian international position in many respects: Vienna regained her role as a financial and trading center, and the implied invisible incomes, several commercial treaties were obtained under the League's auspices and a steady inflow of foreign capital, though largely on short term account, was established. Yet, as observed in connection with the model of Chapter 5, the key to the stabilization was to maintain external balance but at the "target" or "fair" income distribution (or real wage). With the sudden end of inflation workers would be able to

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[26] J. van Walré de Bordes (1924) p. 206.
[27] W. Layton & C. Rist (1925) p. 157.

close the wage gap very quickly thus causing a deterioration in competitiveness.This is indeed observed in Table 8-2 which shows the behavior of an index of real wages and real exchange rates after the stabilization.

With this deterioration in competitiveness little was accomplished in terms of balance of payments adjustment at least as seen in the trade balance which showed continued and strong deficits throughout the 1920s. As seen in Table 2-1 current account deficits as percentages of GDP averaged 8.4% in 1924-1926 and 6.1% in 1927-1928. Little was actually accomplished as far as the more structural adjustments that the new Austria should undertake; the League program did not really give any significant contribution in this respect, much on the contrary the League's obsessive emphasis on budget balance greatly reduced the government's initiatives as regards investment expenditure. The expected huge budget deficits failed to materialize, as observed in the last chapter in view of the extraordinary recovery of tax revenues after the stabilization. In these conditions, the proceeds of the reconstruction loan were put to uses like to form provisions and guarantee funds for its own repayment and to sustain "sound" cover ratios - one could hardly think of more "unproductive" uses. Besides, fiscal austerity and dear money maintained the economy on a chronically depressed state which was obviously not conductive to private investment activity. Such astonishing contrast with the reconstruction strategy implied by the Marshall Plan after World War II - that was noted in Chapter 2 - did not fail to be observed by Austrians[28]. In sum, bottlenecks in agriculture, energy, and transport sectors could be basically solved during the 1920s by a high level of imports made possible by borrowing abroad. Some state initiatives, made timid by the *laissez-faire* philosophy implanted by the League plan, and some direct foreign investment did address some of these issues but without any appreciable effect on the Austrian international accounts. This state of things could persist during the 1920s but not without its tensions; problems of high unemployment of scarcity of capital became nearly chronic complaints. As an exemplary product of the ideas of reconstruction spoused by the authorities of the 1920s, Austria became a debtor economy and thus like many others would pay a heavy price for that in the early 1930s.

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[28] E. Marz (1984) pp. 503-504 and G. Harberler (1982) pp. 66-67.

8.3) Following the precedent: Hungary

The notion that foreign financial help was essential for the Hungarian stabilization grew out of the successive failures collected in stabilization attempts before the League intervention. The first attempt was conducted immediately after the withdraw of the Romanian occupation army, completed only in April of 1920 and followed closely the plan put into effect successfully in Czechoslovakia the year before. The government undertook the stamping of the Austro-Hungarian banknotes in circulation within the new Hungary and used the occasion to attempt a deflationary policy through the retention of a portion of the notes. Prices remained fairly stable from May to October of 1920, but as the exchanges fell approximately 40% and prices rose 23% in the last two months of the year the government decided to launch a wholehearted stabilization experiment under Finance Minister Roland Hegedüs. The new Minister of Finance counted on the unqualified support of the business community; his nomination was received with "enthusiasm" and the announcement of his plans "produced a great impression" especially abroad[29].

Hegedüs program was the exemplary orthodox stabilization program centered on budget balance and the complete stoppage of money creation. It is significant, however, that Hegedüs had a very clear purpose the resort to an external loan at some point in the future; according to a historian, the plan "was to be carried out as a precondition to gain the confidence of the foreign money market which ... once convinced of an effective Hungarian financial policy and will in self-help would come in to help keep the stability of the currency"[30].

[29] E. Hantos(1927) p. 63. Hegedüs was professor of financial and fiscal science at the University of Budapest, for a while director of the Commercial Bank and president of the Association of Hungarian Banks and Savings Banks. Hegedüs "was a true representative of the alliance between the traditional Hungarian ruling class and the new business elite ... after the difficulties of revolution and counterrevolution whose economic policies ... were harmful to business interests , Hegedüs was regarded as the man who would carry out an economic policy promoting economic restauration and stabilization ". Cf. G. Ránki(1983) p. 525 and M. Mitzakis(1925) pp. 150-151.

[30] Emphasis in the original. Cf. E. Boross(1985) p. 202. According to another historian, "one of the objects pursued by Dr. Hegedüs in undertaking drastic measures for the balancing of budgets, was to create a condition, in which Hungary might be able to raise foreign loans for the purpose of making up the deficit in her balance of payments". Cf. L. Pasvolski (1928) p. 307.

Indeed, during the first semester of 1921 the money stock remained roughly constant while the exchanges appreciated approximately 55% and prices fell by 38%. As the exchanges started to show signs of weakness in June, Hegedüs insisted upon tightening the fiscal contraction but the Parliament, alarmed with the very high levels of unemployment, was reluctant and eventually refused to pass the proposed fiscal reform leading to his resignation. Many historians attribute Hegedüs failure to difficulties in implementing and maintaining budget balance[31]; yet the episode seemed to demonstrate that the Hungarian problem could not be solved by fiscal contraction or by unemployment. In this connection there seems to be a consensus among historians that the experiment "showed definitely that the financial rehabilitation of Hungary was impossible as long as the international position of the country remains what it was ... [therefore] the failure of Hegedüs' program of reforms clearly indicated the need for foreign financial intervention"[32].

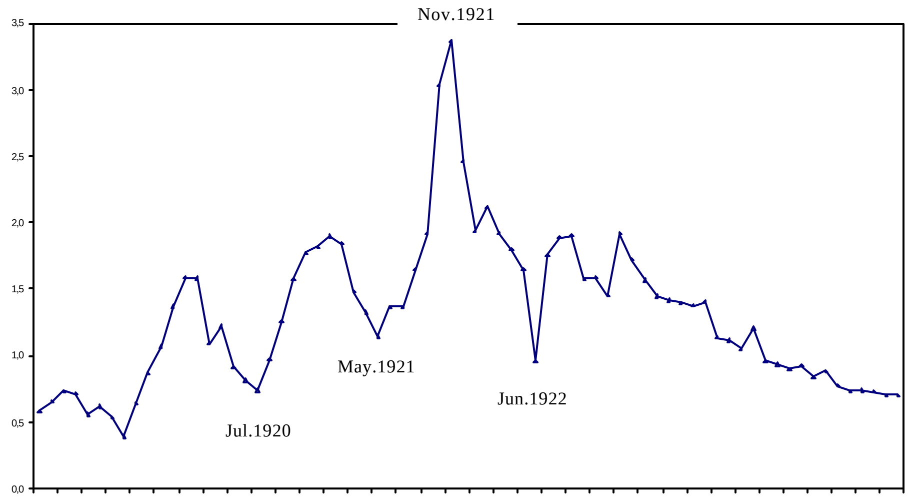
But as in the other countries the problem was not merely that Hungary faced a nearly unmanageable payments position but this combined with the inevitable recovery of wages towards the pre-war levels; the incompatibility between the need for increased competitiveness and the desire for higher wages lay at the root of the Hungarian inflation. This is illustrated in Chart 8-1 by the behavior of the real exchange rate and by the somewhat scanty information available on real wages summarized in Table 8-3. It is interesting to observe in the chart that the real exchange rate shows an unambiguous tendency towards depreciation during the early half of the period, or up to the peak observed in November of 1921. This tendency was interrupted three times by aborted stabilization attempts that maintained exchange rates stable for some time (or produced appreciation) while workers attempted to obtain real wage gains. The first episode was the deflation simultaneous with the stamping of the old imperial notes, the second was the Hegedüs program and the third was an experiment with exchange controls that succeeded to hold exchanges stable early in 1922. In each of these episodes workers

[31] L. L. Ecker-Rácz(1933a) p. 84, L. Pasvolski (1928) p. 307 and G. Ránki (1983) p. 526 and E. A. Boross(1985) p. 203.

[32] L. Pasvolski(1928) p. 307. See also L. L. Ecker-Rácz(1933a) pp. 96,110 and 113 and (1933b) p. 471, LN (1926b) p.11, J. Guillemain (1925) p. 109 and J. P. Young(1925) vol. II p. 119.

managed to regain some ground but at the cost of weakening competitiveness[33].

Chart 8-1
Hungary: Indexes for real exchange rates, 1919-1924



SOURCES and OBSERVATIONS: Value of the gold crown in terms of paper crowns divided by Pester Lloyd wholesale price index from L. L. Ecker-Rácz (1933a) pp. 61-62.

The information on real wages in Hungary is not very good and it is available only for a few points in time, being difficult to infer what happened in between. The behavior of real wages observed in Table 8-3 seem to contrast to what is observed elsewhere for there seems to be an upwards trend. After a slight fall from October of 1921 to September of 1922 real wages rose very significantly, between 40% and 50%, through September of 1923 and some additional 15% to 20% to September of 1924. This seems consistent with the continuous deterioration in competitiveness shown in Chart 8-1 from the Autumn of 1922 up to the end of 1924.

33 As regard the third episode, for instance, it was observed that "as the purshasing value of the monetary unit sank to its real exchange value the demand for higher wages become more insistent to meet living expenses , and because the export of industrial articles was only possible on account of cheap labour ... at the present time over 70.000 industrial workers are out of work or on strike". Cf. R. J. E. Humphreys (1923) p. 5.

Table 9-3
Hungary: Indexes for real wages 1921 - 1924
(1914=100)

categories	Oct.1921	Sep.1922	Sep.1923	Sep.1924
Skilled Workers	46	43	65	73
Semi-Skilled	48	44	63	71
Unskilled	58	49	66	75
Females	44	40	64	70
Juveniles	59	46	62	79

SOURCE: ILO (1926) p. 92.

This apparently singular behavior of real wages can be explained by the actions of the authoritarian government. It is important to observe that the levels of real wages in Hungary are much lower than what is observed elsewhere, even after the stabilization. In the other three countries real wages were pushed up until recovering pre-war levels before the start of the hyperinflation; at this point Hungarian wages barely reached 50% of pre-war levels. During the last months of the inflation real wages in Hungary were not significantly greater than we observe elsewhere; the singularity of the Hungarian experience seems to be the fact that there was not a peak in real wages before the hyperinflation, or that there was no (temporarily) successful wage-push as observed in the other countries.

This is not at all incompatible with the existence of an incompatibility between desired wages and external balances to be "solved" by inflation; increases in real wages are obtained in the model of Chapter 5 for increases in unemployment and/or downwards "revisions" in wage demands by negotiation or by force. The authoritarian regime's policies towards unions did manage to impose the burden of adjustment on the working classes: pre-war wages would not be reached even by the early thirties and unemployment averaged 15.4% for 1924-1926, a marked contrast to what is observed in the other cases. As far as medium term adjustment problems were concerned the reopening of international capital markets to Hungary would play a very important role in removing the external constraint or at least in permiting some recovery of real wages and reductions in unemployment. The short term stabilization problem depended on a loan, and Hungary faced some very serious difficulties in this respect.

After the Hegedüs failure the repeated initiatives of the Hungarian authorities towards obtaining foreign credits[34] met two main obstacles: one was Hungary's reparations obligation which was far from being handle by the Allies with the same benevolence they had with Austria[35]; and the other was the especially tense relations between Hungary and her neighbors[36]. The implementation of the League scheme in Austria, and its apparent success early in 1923, left Hungary no alternative to obtain foreign credits other than to adopt a similar program. Despite its obvious costs, the League scheme offered Hungarians an unique opportunity to obtain a favorable settlement of the reparations bill[37]; it also opened new perspectives as regards the relations between Hungary and the other Successor States not only as regards the political and territorial disputes that could be arbitrated by the League but also with respect to commercial treaties that could reactivate, at least to some extent, Hungarian exports to the Danubean area[38].

The Austrian precedent was very important to circumvent the diplomatic intricacies involving Hungary, the Reparations Commission, the creditors of relief credits and the other Successor States. In the late fall of 1923 when it became clear that the Reparations Commission would invite the League to draw a stabilization program, as it effectively did in October 17th, the exchange rates were stabilized. The government, however, did not have the means to sustain the stabilization for very long; international reserves at this point were reportedly insignificant and the floatation of the stabilization loan lay ten months ahead. This would be dramatically confirmed at the end of the year when the financial crisis originated by the stock exchange crash in Vienna was communicated to Budapest resulting in a run on the crown[39]; though that was also partly generated by "some difficulties in the loan negotiations [that] had aroused fears that they would not succeed"[40].

The crown fell 13% in December, nearly 60% in January and further 5% in

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[34] M. Myers (1945) p. 506, M. Mitzakis (1925) p.169, LN (1926b) p.11 and H. Clay (1957) p. 190.
[35] H. G. Moulton & L. Pasvolski (1932) pp. 234-236 and I. Berend & G. Ránki (1974a) pp. 184-185.
[36] L. Pasvolski (1928) p. 308.
[37] G. Ránki (1983) p. 528.
[38] L. L. Ecker-Rácz (1933a) pp. 114-115.
[39] M. Mitzakis (1925) p. 160 and LN (1926b) p. 28.
[40] LN (1926b) p. 28.

February without any attempt to arrest that movement. In March, with a League delegation already installed in Budapest and the solemn signature of Protocols similar to the Austrian ones in Geneva, the depreciation was halted; yet the government still lacked reserves to sustain the peg. A domestic "forced" indexed loan[41] was floated between March and June yielding approximately 6 millions dollars; an advance of 3.4 millions dollars was obtained from Budapest banks on security of grain stocks in April, and the remains of the proceeds of the liquidation of the Austro-Hungarian bank, approximately US$ 2 million, were all used to prevent further depreciation. The gold value of the money supply was US$ 42.2 million in February and US$ 24.1 million in March so that these contributions, though significant, were far from being decisive. In April it was known that New York bankers refused to place the US tranche of the reconstruction loan; the Bank of England then advanced £ 4.0 million, or approximately US$ 18 million, but contingent on the stabilization being made with respect to the pound sterling, which was promptly effected[42]. The subscription of the new bank of issue was closed in May and 50% of the capital, the equivalent of US$ 3.1 million was paid up in gold. When the new bank opened for operations in June its reserves totaled only US$ 9.7 million covering only 30% of the money supply as shown in Table 8-4 .

Table 8-4
Hungary: international reserves, dollar value of the money supply and cover ratio, 1924
(millions of dollars)

Month	Money Supply	Int'l Reserves	Cover Ratio
June	31.8	9.7	30.5%
July	39.4	17.2	43.6%
August	47.6	20.3	42.6%
September	53.5	21.3	39.8%
October	52.3	23.9	45.7%
November	57.8	25.7	44.5%
December	58.7	27.3	46.5%

SOURCE: J. P. Young(1925) vol. II p. 32.

The reconstruction loan would be floated in July and August providing a net yield

[41] Composed of bonds indexed to the *sparkrone* price.
[42] F. de Fellner (1925) p. 282, M. Mitzakis (1925) p. 283 and L. Pasvolski (1928) pp. 314-315.

of approximately US$ 51 million. The loan was thus much smaller than the Austrian one; this was due to the fact Hungary had a lower stable-prices money supply, around US$ 80 million as compared to Austria's US$ 110 million. Hungary was also a much more closed economy commercially (exports represented about 24% of GNP for Austria and 18% for Hungary) and financially. Besides it seemed obvious that the Austrian loan had been too big.

The Hungarian plan had only slight differences with respect to the Austrian one. The reconstruction loan would enjoy no garantee from the Allies, being secured instead by certain government revenues, the customs duties, the sugar tax and the tabacco and salt monopolies proceeds, to be held in blocked accounts under the control of the Commissioner-General. A significant contrast with the Austrian scheme was that an effective schedule of reparations payments was established by which Hungary should pay an yearly average of 10 million gold crowns, which was equivalent to around 1% of 1926 exports, during twenty years to start after the reconstruction period[43]. The system was innovative in that the reparation payments were made in paper crowns to the Commissioner-General who could decide on the suspension of payments if he considered budget equilibrium to be endangered, and also should manage to effect the transfer of such payments, or to postpone it, as not to pressure the exchange rate. This was the origin of similar arrangements implemented by the Dawes Plan in Germany[44].

Financial policies were not as contractionary as in Austria, though still very much so, as there seemed to be a feeling that fiscal and monetary restraint had been excessive in Austria. The new bank of issue applied the same discount rate inherited from the old, namely 10% for credits in *sparkrone*, and the Commissioner consented in utilize the proceeds of the loan for investment projects much earlier than in Austria. Unemployment was high, averaging over 15% of unionized workers in the second semester of 1924, yet, as in Austria, a large external loan under strict conditionality was the fundamental element for the success of the stabilization for it redefined entirely the Hungarian payments position. Following the loan a steady inflow of foreign capital into Hungary was established, as observed in Chapter 2, which accommodated the chronic trade deficit

[43] The reconstruction period was considered to be the period within which the Commissioner-General would be in residence, which was initially estimated to last two years.

that Hungary presented throughout the 1920s. No doubt these trade deficits can be traced, to some extent, to the deteriorating competitiveness produced by the workers' pursuit of pre-war real wages. It is also true, however, that in contrast with the other countries real wages in Hungary stabilized at levels no greater than 80% of pre-war levels so that works did accept a reduction in the standard of living. On the other hand the League did not exercise a healthy influence on the country's willingness to undertake industrialization. On the contrary the League fostered laissez-faire notions and emphasized the country's agricultural comparative advantage wiping under the rug all the necessary structural adjustments to the new frontiers as all as the tensions between the backwards agricultural sector and the emerging industrialists. No doubt the Hungarian payments disequilibria that persisted unnoticed during the 1920s, thanks to capital inflows and "sound finance", resulted from this lack of adjustment. Like the others, Hungary would pay a very high price for that during the early 1930s when foreign capital ceased to be available.

8.4) Summary and Conclusions

The mechanism of stabilization in Austria and Hungary was very simple, a large loan could convert the money supply almost entirely on gold; this meant to shrink inflation to the levels observed in the gold standard countries. Then a continuous inflow of foreign exchange was established that assured a medium run compatibility between external balance and target real wages. Adjustments in the margin were provided by contractionary policies that basically adequated the current account to the availability of foreign capital such as to maintain a very high gold cover for the currency. In Hungary specifically a significant part of the burden of adjustment feel on workers - who had to withstand a significant reduction in their standards of living - which was basically attributed to the authoritarian government that ruled throughout the 1920s.

The experience of Austria and Hungary provides a typical picture of a well behaved adhesion, even though forced, to the gold standard and perhaps the best possible demonstration of the principles of Brussels and Genoa. Yet it was an essentially financial solution for a problem that was only partly, if at all, a financial problem. The inaction of

[44] LN(1926b) pp. 22-23.

the League and of its local followers towards the more structural necessities of these economies would result that these economies structural problems would not be addressed. This non-adjustment could only be sustained thanks to the relative abundance of foreign capital in the 1920s; by the early 1930s when this ceased to be the case these economies would be again confronted with the same basic imbalances. In sum, these programs succeeded to arrest inflation, which, however, was not such an achievement in view of the amount of resources made available by the League loans; the real challenge for these programs was the medium and long run balance of payments adjustments. In this sense these programs failed and fortunately the lesson was learned, or at least it was remembered after the next war when the Marshall Plan offered a very significant example of an alternative strategy, as discussed at some length in Chapter 2.