Clemens Jobst / Hans Kernbauer

The quest for stable money

Central banking in Austria, 1816–2016

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Introduction

Milestone birthdays present an opportunity to reflect not just on one's own age but also to anticipate upcoming family birthdays of significance or recall past family anniversaries. Central banks are no different in this respect. Many central bank histories start with a reference to the oldest surviving member of the family, the Swedish Riksbank, founded in 1668. In the genealogical table of the oldest central banks in the world, drawn up by Forrest Capie, Charles Goodhart and Norbert Schnadt in their seminal contribution marking the tercentenary of the Bank of England, the privilegirte oesterreichische National-Bank (OeNB) comes in sixth.[1] Apart from the above-mentioned Sveriges Riksbank and the Bank of England (1694), the only central banks founded before the OeNB were the Banque de France (1800), the Bank of Finland (originally established as the Finnish Office for Exchange, Lending and Deposits in 1811) and De Nederlandsche Bank (1814). Finishing sixth was in fact close for the OeNB: Founded on June 1, 1816, it is just 13 days older than Norges Bank.

Yet this genealogy does not list defunct family members like the Banco di San Giorgio (1407–1805), the Bank of Amsterdam (1609–1820), or the Wiener Stadtbanco (1706–1816), precursors who would change the ranking had they survived.[2] Moreover, central banks' birth dates are frequently stated with the reservation that early on, these banks had few similarities with contemporary monetary authorities, evolving into central banks as we know them only in a slow process and over an extended time span. Passage to adulthood, to continue the analogy, is generally linked to the assumption of a lender-of-last-resort role, meaning the provision of sufficient central bank money during a financial crisis if required. To this end, the central bank must have "grown up" to be a neutral, nonprofit-oriented economic agent who acts in the general economic interest rather than competing with other commercial banks.[3]

Two recurring challenges

Now, if the OeNB was born in 1816, when did it reach adulthood? The eventful history of Austria's central bank does not lend itself easily to a teleological interpretation according to which early banks of issue developed into modern central banks at a determinable point in time. Thus, rather than judging at what point and to what degree the OeNB fulfilled modern-day criteria of central banking, a more appropriate approach is to view the bank as an institution that operates in a space that both in the past and today is defined by two dimensions: monetary stability and financial stability.[4]

Of course, the meaning of monetary and financial stability has changed during the past 200 years. Originally, money was considered to be stable if all coins were struck with consistent amounts of metal; later, the notion of monetary stability was linked with the convertibility of paper money against coins with a specified metal content. Not until the 20th century was monetary stability understood as the stability of a broadly defined index of consumer prices. Financial stability, on the other hand, has typically been a much broader concept, embracing the smooth operation of payment systems; last resort lending; the supervision of individual banks and other financial intermediaries; or the prevention of macroeconomic imbalances such as real estate price bubbles driven by excessive mortgage lending, which may jeopardize the stability of the entire financial system. The basic issue of monetary and financial stability has always been the same: Since money has been around, the sovereigns who exercised the right of coinage had an incentive to finance their expenditure by debasing the currency, either by reducing the weight of coins or by adding base metals to the alloy. Numerous instances of inflation from Classical antiquity to the modern age demonstrate this process; paper money, once it had been invented, made debasement only easier. As money and credit are closely related, financial crises have a long history as well.

Thus, upon its birth in 1816, the privilegirte oesterreichische National-Bank entered a well established area of politics in which it came up against a traditional player, the state, and the legacy of a municipal bank that was in some ways its predecessor and that used to be closely associated with the state: the Wiener Stadtbanco. The arrival of a "national bank" was a game changer insofar as the new bank was endowed with tasks and decision-making duties that had formerly been under the jurisdiction of the finance ministry. At the same time, the new bank received (at least some) independence from the state and some freedom from direct state control. Over time, the actual allocation of individual monetary policy responsibilities among the bank and other economic agents, especially the state, changed several times, as did the general economic and political setting within which monetary policy was run.

Looking at the 200-year history of the OeNB reveals that monetary policy again and again faced conflicting choices: *first,* the provision of a stable legal tender versus inflationary incentives to finance the state and boost the economy; *second*, the delegation of economic policy to an independent central bank versus the need to control this bank; *third,* transparency and accountability versus confidentiality; and *fourth*, a close versus a more arms-length relationship with the banking sector. Similarily, the issues that needed to be resolved against this backdrop of conflicting choices resurfaced time and again: Should exchange rates be flexible or fixed, and to which currency should fixed exchange rates be pegged? How should wars be financed? How should excess money in the aftermath of wars be handled? How should illiquid or insolvent banks be dealt with? How can the build-up of imbalances in the financial system be stopped? Should internal or external stability take precedence? Should capital movements be restricted? With regard to the broader institutional framework conditions, the latest game changer was the creation of the Eurosystem. In the Eurosystem, which comprises the European Central Bank (ECB) and the national central banks of the euro area countries, including the OeNB, central banking decision-making has largely shifted to the European level. Yet here, too, the same issues arise and the same decisions need to be taken as in previous decades and centuries.

Reading the past in the light of the present

These recurring themes are also reflected in the narratives of the OeNB's history. Of course, as a central actor in domestic and occasionally, like in 1857 or 1931, international economic policy, the bank deserves a prominent place in any account of Austria's political and economic history. Often, the questions and methods with which the history of the OeNB has been interpreted were influenced by big conceptual swings in historical science. An example of the significance of international trends for the historiography of Austria is the abundant literature on 19th century economic growth, which was produced at the same time as a similar literature on other European countries.[5] However, the regular resurfacing of the same issues and problems in monetary policy means that narratives of central bank history are likely to have been influenced more strongly by current issues than other areas of historiography. This is true even of the comprehensive chronology of OeNB history that historian Siegfried Pressburger compiled in the 1960s and 1970s: Although his narrative meticulously follows the sources he consulted, it at the same time echoes the themes that dominated the economic policy debate of the time–demand management and exchange rate policy–wherever he made reference to current themes.[6]

In the case of studies focusing on selected aspects of Austria's monetary history, the impact is to be felt to an even greater extent. Thus it comes as no surprise that a number of studies written during inflationary World War I and immediately afterward would closely examine the sovereign default and the currency reform following the inflation during the Napoleonic wars.[7] More recently, the dissolution of the Soviet Union and the breakup of Czechoslovakia revived interest in the collapse of the crown currency area after 1918. By the same token, the European unification process and the discussion surrounding the design of the Economic and Monetary Union in Europe prompted analyses of the operation of the partly similarly structured currency area in the dual monarchy before 1918.[8] The transition from the Austrian schilling to the euro in 1999 spawned a number of studies exploring the history of the schilling.[9] The discourse on the merits of fixed versus flexible exchange rate regimes is an evergreen in debates on economic policy.[10] Last but not least, the banking crisis of 2008 rekindled researchers' interest in the crises of 1873 and 1931, while the international financial support programs for Greece, Ireland and Portugal sparked a review of the League of Nations loans and related foreign control of Austrian fiscal policy in the 1920s and 1930s. These studies have either been published in recent years or are forthcoming.[11]

Partly, the choice of perspectives and topics is driven by the ambition to draw lessons from the past to help solve the urgent problems of the present. Yet it is just as important that current events lead us to question and redefine our understanding of the past. After all, the conventional wisdom no longer appears adequate in numerous cases, either because recent experience has cast doubts on the logic of old interpretations or because aspects and details of particular interest to us today have not been covered in the existing histiography. For instance, overview publications summarizing the OeNB's history in the 19th century largely neglected the role of the bank in the economic integration of the monarchy and barely scratched the surface in examining the relationship between the central bank and commercial banks. A closer look at these topics is relevant against the backdrop of the European integration process and of the new role of central banks and the EU today, and at the same time casts new light on the evolution of the OeNB from the treasury's banker to the banker's bank, a subject that was given short shrift in older publications.

This book is the first endeavor since Othmar Bachmayer and Siegfried Pressburger wrote their surveys of Austrian monetary history 50 years ago to provide a concise yet comprehensive overview of the history of the Oesterreichische Nationalbank. Since then, the collapse of the post-World-War-II monetary order under the Bretton Woods system, Austria's hard currency policy and the introduction of the euro have added important new chapters to the bank's history. Additionally, new works on the history of Austria's central bank published in the past 50 years have inspired us to reassess some of the older accounts. Finally, this history represents an opportunity to assign greater weight to the role of the OeNB in securing financial stability and to its role as the banker's bank than previous historical treatises did. To better meet the objective of delivering a compact overview, we have focused on selected developments in the two key areas of central bank policy: monetary stability and financial stability. Rather than providing an all-encompassing history of the OeNB, we favor overview descriptions over a chronological narrative wherever possible, omitting events that are not needed to understand the big picture. Issues not limited to a particular era or chapter, such as the definition of lender of last resort or monetary policy operations, are treated in boxes. For further reading, readers may turn to the ten-volume work heavily based on internal OeNB documents that Siegfried Pressburger began on the occasion of the 150th anniversary of the OeNB and that was completed with contributions by Hans Kernbauer and Fritz Weber in recent years. Pointers for further reference are provided in our exhaustive bibliography.

A first try at monetary autonomy–the Wiener Stadtbanco (1706–1816)

"The paper money scissors absolutely have to be taken out of the treasury's hands … History and experience have invariably shown that if the power to cut out paper money lies with the public administration, it is as if a child had been handed a knife: It is impossible to prevent the treasury from damaging the country."

Count Zinzendorf in a petition
to the emperor submitted August 1, 1806[12]

On June 1, 1816, Emperor Francis I signed the decrees establishing the privilegirte oesterreichische National-Bank, almost exactly one year after the conclusion of the Congress of Vienna marking the end of a 20-odd-year period of wars in which Europe and Austria had been embroiled. Ultimately, the Austrian Empire emerged as one of the victorious powers, albeit with empty state coffers and a depreciated currency. The pressing tasks of the newly founded note-issuing bank thus consisted in supporting the state in restoring financial order and in reestablishing a sound currency.

The National-Bank was not the first bank Austria had created to shore up government finances. The first proposals to found banks based on Italian models were made in the first half of the 17th century, but they were never implemented.[13] Not until some 80 years later were financial institutions established that should assist in securing long-term financing for the public budget: the Banco del Giro, founded in Vienna in 1703, and the Wiener Stadtbanco, the Vienna City Bank, established in 1706.

Public banks in the 1600s and 1700s—innovative payment services and public debt management

On foundation, the Banco del Giro and the Wiener Stadtbanco joined the ranks of some 25 public banks already established across Europe.[14] These banks were operated by the treasury, by autonomous provincial or municipal entities, or by groups of people endowed with special rights and privileges by government.[15] The first public banks were set up in the late Middle Ages in the western Mediterranean area; banks in the Netherlands and Germany followed in the 16th century. Public banks were generally founded for one of two reasons, one being the need for an institution that would provide a stable means of payment. This was the case in Amsterdam, Genoa or Hamburg, which had suffered from the simultaneous circulation of different types of coins of varying qualities before the advent of public banks, whereas in Venice, cashless payment transactions had come to a standstill after the private banks that had handled them became insolvent. A second reason to found a public bank lay in the hope of facilitating the management and servicing of the public debt. To this end, national or municipal debt to individuals was–in simplified terms–converted into deposits with the public bank. These deposits were tradable through transfers and could be used as a means of payment for private transactions. Such arrangements providing for the transfer of debt into a form of money made holding public debt more attractive, so it became easier for the government to take out new debt. Ergo, these banks' common feature consisted in the creation of book money–deposit currency that had a more stable intrinsic value than coins or holdings with private banks and that was thus the preferred instrument for payments or could be traded more readily than other public debt instruments. Providing a stable means of payment and making government debt tradable are of course closely linked functions, as the Stadtbanco example will show below. At any rate, for all their differences, the public banks of the 15th to 18th century were the precursors of modern central banks, given their pivotal role of creating a liquid means of payment with a stable value.[16]

The banking models which evolved in the 15th and 16th centuries were further refined and adjusted over time. The mainspring of these developments were innovations that enhanced the quality of financial instruments–debt instruments and especially payment instruments. For such advances to catch on, their advantages had to accrue to issuers–the banks or the public administration–and to users of the instruments alike. Clearly, issuers had a vested interest in their instrument being used, which in the long run would happen only if people were willing to adopt it. Innovations could be technical, legal or institutional. Banknotes are an example of a technical innovation (pioneered by Sweden, France and England) that broadened the reach of money transfers because it freed businessmen from the need to hold an underlying bank account to make or receive payments. A legal innovation was the possibility of paying taxes without physically transferring coins, another winning feature of banknotes and bank deposits. Finally, an example of an institutional breakthrough was the removal of the bank of issue from the direct control of the state, preventing the government from covering its expenditure by putting too much money into circulation. The independence of the bank of issue protected monetary stability and increased the appeal of banknotes and ledger money alike.

A bankrupt sovereign in need of a public bank

The merits of public banks for a well-functioning economy and for a high credit standing of the state did not go unnoticed in Austria. Indeed, a number of blueprints were developed in the 17th century for banks that would facilitate payments and support trade.[17] Yet the first public bank to be actually established in Austria in the early 18th century was clearly created for another key reason: out of the need to improve public debt management.

Public finances in Austria around 1700

The driving force behind the foundation of the Banco del Giro in 1703 was the looming insolvency of the state following the death of the merchant and banker who had played a central role in public finance, Samuel Oppenheimer. The very fact that a single individual could be a linchpin is indicative of how public finances were organized during the reign of Leopold I: They were inextricably bound up with the identity of the reigning monarch. Revenues and expenditure as well as debt were connected to the monarch ad personam.[18] Technically, the national budget was dependent on two revenue streams, which theoretically fed two expenditure streams. One stream of revenue was the income that arose from royal prerogatives, like monopolies, returns from mining rights and the rights to levy tariffs, customs and excise duties. This revenue–the *camerale* revenue, i.e., income administered by the court treasury *(Hofkammer)*–was mainly channeled into civil spending. The funds for the military budget resulted from tax income, called *contributionale*[19] income, the collection of which had to be authorized by the diet in which the nobility, the clergy and the municipal administration were represented. Above all during wartime, the authorized expenditure was often less than needed, and the representatives of the estates wielded their power of assent to elicit concessions from their sovereign in other matters. Not surprisingly, the negotiations often proved arduous.[20] Time and again, the sovereign was forced to bankroll gaps in the military budget by drawing on the *camerale* budget or by borrowing, even more so as Austria was in a state of almost permanent warfare.

Just like all state revenue went to the sovereign ad personam, all debt incurred was his personal responsibility, not that of the state.[21] Debt was generally collateralized by pledging earmarked revenue to which the sovereign was entitled, like customs or tolls. Binding debt ad personam to the sovereign subjected such transactions to high risk. The rule of law was not fully developed, and the sovereign's dealings with his creditors were autocratic and arbitrary. If the coffers were empty, creditors could face unilateral extensions of payment deadlines or see short-term claims rolled over into long-term debt. Creditors with less clout could be turned away; major creditors could be charged as criminals or jailed.[22] Many of the government's business partners were, moreover, at a disadvantage in transactions with the erratic authorities because they were members of a religious minority. Jews were especially vulnerable: All Jews had been expelled from Vienna within recent memory, in 1670, and the few families that had been permitted to settle in Vienna since were subject to tough restrictions.[23] As timely payments by government depended on the negotiation skills of individual creditors, government promises of payment were virtually untradable. Thus it was that around 1700, only few creditors were willing or able to lend the sovereign money. For the government, the lack of attractiveness of its debt securities meant that it had to pay high interest of between 6% and 12% or temporarily even 20% on long-term debt; short-term and thus more pressing loans commanded even steeper rates.[24]

To effectively wage war and to meet all other official expenses in this system, the sovereign depended on wealthy private-sector financiers for buying weapons, keeping the troops supplied, procuring goods and, of course, funding the related transactions. In Vienna, this money came from a group of warehousers and court suppliers, who served as both brokers of goods and brokers of money:[25] merchants were bankers and vice versa. The business model drew extensively on international family networks that facilitated trading and banking. Most of all, the networks also gave merchants and bankers access to their business partners' considerable financial resources for onward lending to the sovereign. These merchant families were by no means all Jewish; Protestants also played an important role.[26] In addition to providing their own capital, the court agents also negotiated loans from the nobility and high officials to the sovereign. For these lenders, engaging the services of a court agent had benefits: The court agent was sufficiently indispensable to the emperor to enforce his claims–and thus indirectly those of his suppliers and creditors–against the emperor. But the mutual dependency of the sovereign and the financiers as well as the powerful role of individuals made this system highly vulnerable to disruptions.

In Western Europe the state emancipated itself progressively from the reigning monarch during the 17th and 18th centuries. This dissociation was the prerequisite for a modern market for government debt.[27] The Habsburg monarchy embarked on this process later than other countries: It did tap the existing Western European markets to issue bonds from the late 17th century onward, collateralizing the bonds with revenues from copper and mercury mining.[28] Domestically, though, the government broadly retained its funding habits. Yet by the beginning of the 18th century, the decision makers had realized that the framework of public finance governance, in particular public debt management, had to be improved on the pattern of foreign models. Oppenheimer's death in 1703 very dramatically exposed the system's weak spots.[29]

Oppenheimer had been truly essential in keeping Austria's public finances afloat.[30] On his decease, scores of creditors turned to the government for satisfaction with the argument that Oppenheimer had merely brokered their business and that their claims on Oppenheimer ultimately represented claims on the state. As the state did not have the funds to service its debts with Oppenheimer, it imposed a moratorium, thus precipitating a general financial crisis. The need to mitigate the immediate impact of the bankruptcy and the foresight to address the basic problems of state debt management at the same time led to the creation of the Banco del Giro, a bank that was not only named after its Venetian namesake created in 1619 but also copied its business model: making claims on the state, notably those from the Oppenheimer bankruptcy, transferable in the form of bank accounts.[31] The respective claims would thus no longer be assertable directly for payment in cash from the state, but instead be kept in circulation as book money. If accountholders found that book money was useful for facilitating payments, the state even stood the chance of attracting additional deposits from individuals in the medium term–provided the liabilities of the Banco del Giro were credibly backed. That was to be achieved by assigning selected state revenues as collateral. And this is the very point at which the project failed: The provinces and the court treasury, the body in charge of administering the *camerale* budget and thus the precursor of the finance ministry, insisted that tax revenues were earmarked and could not be reallocated at a whim. Hence, the Banco del Giro did not obtain the funds it needed and was unable to fulfill the role it had been assigned. While it continued to exist as part of the Stadtbanco founded in 1706, it no longer played a role as an independent institution.[32]

Benefiting from Vienna's credit score—the Wiener Stadtbanco

In the meantime, Count Gundaker Thomas von Starhemberg, head of the court treasury since 1703 and hostile to the Banco del Giro, was promoting banking projects of his own, which were crowned with success after the death of Leopold I and the accession to the throne of Joseph I in 1705. Like the masterminds of previous bank plans for Austria, Starhemberg was well aware of the achilles heel of any public bank in an absolut monarchy: The ability to build public trust hinged on independence from the state, and building trust was a prerequisite for getting citizens to make deposits and accept money issued by the bank in payment. To build trust in the independence of his initial banking project, Starhemberg intended to give a prominent role to the estates of the Austrian and Bohemian crown lands. His rationale was as follows: being representative bodies, the estates had the right to levy taxes and enjoyed autonomy from the emperor and were thus in a position to lend financial support to the bank.[33] The scenario that was actually implemented in 1705 accorded this role to the City of Vienna, which was an integral part of the Lower Austrian estates. Starhemberg thus copied a system that had worked well in France, where the king exploited the good credit score of the municipality of Paris to raise new debt more easily and at a lower cost.[34]

The bank thus created started to operate in 1706 under the name of Wiener Stadtbanco.[35] Unlike the business model proposed earlier, which intended the bank to use its deposit base in support of trade and industry, the sole purpose of the Stadtbanco was to fill the state's war coffer. To this effect, the state transferred part of its debt to the municipality, which assumed responsibility for the payment of interest and capital on the debt and received earmarked tax revenues in return. To secure the public's trust, the bank was run by municipal government officials, and the municipality of Vienna also provided guarantees for the bank's liabilities. The Stadtbanco's independence from influence was meant to ensure that the bank accepted government debt only if it was appropriately covered by tax revenues.[36] Depositors were promised exemption from taxation and protection against seizure of property, especially during wartime. This was a material advantage particularly for foreign creditors. In return, the Stadtbanco had to cede any profits from its more efficient administration of the pledged taxes or from lower interest on debt to the state. In other words, like the Banco del Giro, the Stadtbanco was not a bank in the modern sense, but a special agency administering the public debt. It generated advantages for the state's creditors and thus made holding state debt more attractive, which in turn made it easier to finance the public debt at a lower interest rate.

In reality, the role of the Vienna municipality in administering the bank was far weaker than the public was led to believe, and it was curtailed more and more over time. As a case in point, the *Ministerial-Bancodeputation*–the supervisory body first installed to represent the finance ministry at the Stadtbanco–was given the right to intervene directly in operations as early as in 1706.[37] In 1716, the magistrate lost the right to appoint the bank's officials. In retaliation, the municipal authorities in 1717 announced that they would be liable for the Stadtbanco's debt only to the extent of the anticipated income on the revenue assigned to the bank.[38] Increasingly, the separation between the bank and the treasury existed only on paper.

Despite the close association between the Wiener Stadtbanco and the court treasury, the new institution nevertheless succeeded in gaining the trust of the public over time. At the outset, the bank was mainly engaged in setting up and managing interest payments on the claims on the predecessor bank, Banco del Giro, and in rolling them over into longer-term debt of the Stadtbanco. It also succeeded in increasing profits by managing the taxes and duties transferred to it more efficiently. From 1712, the bank received growing volumes of deposits that could be withdrawn anytime subject to a period of notice that was contingent on the amount withdrawn. By 1724, some 90,000 investors had made deposits with the Stadtbanco, bringing the total volume to several million florins.[39] No small part of the Stadtbanco's success was due to the scarcity of interest-bearing, liquid investment alternatives in the early 18th century. The Stadtbanco was particularly attractive for small investors. The estates of deceased craftsmen, for instance, frequently contained deposits of 100 to 1,000 florins, sometimes also more.[40] The circle of government creditors expanded, marking another key step toward reducing the dependence of government on a single creditor.[41] The great appeal to investors was reflected by the drop in the interest rate on government debt from between 9% and 20% at the start of the century to just 5% to 6% in the late 1720s. Consequently, all 6% government bonds were converted into 5% bonds in 1732 and into bonds carrying only 4% interest in 1766.[42] At the same time, the Stadtbanco's high credibility made it possible to raise large volumes of funds for the state at short notice if required.[43] From the finance administration perspective, the Stadtbanco was thus a tremendous success.

The further biography of the Stadtbanco was conditional on the development of the fiscal deficit. The government tried to take advantage of the Stadtbanco's favorable financing conditions without going so far as to endanger the bank's credibility and the confidence in its liabilities. It is hardly surprising that differences of opinion often arose between the bank's management and government officials about defining the limits of government borrowing. Moreover, the different perceptions were compounded by political conflicts. Emperor Charles VI, for example, was less well disposed toward the bank than his predecessor, Joseph I, and attempted to establish a new bank that was directly answerable to the state. This institution, *Universal-Bankalität*, operated from 1715, but with little success. It had to be taken over by the Stadtbanco in 1721 to prevent its insolvency.[44] The Stadtbanco, though, proved to be an effective support in financing the numerous and, on occasion, long drawn-out wars against the Ottoman Empire and France. A comparison of the public debt at the beginning and at the end of Charles VI's reign illustrates the Stadtbanco's importance: The volume of direct government debt financing–money the state received directly from creditors–barely changed from 1711 to 1740 and came to