

Selected Writings of Ludwig von Mises
Volume I:
Monetary, Fiscal and Economic Policy Problems
Before, During and After the Great War

Introduction
by
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The articles and lectures included in this volume by the Austrian economist, Ludwig von Mises, were written in the years before, during, and after the Great War of 1914-1918, as the First World War used to be called. They focus on the monetary, fiscal and general economic policy problems of, first, the Austro-Hungarian Empire and, then, the new postwar Austrian Republic after the dismantling of the Habsburg Monarchy.

For those who may be familiar with Mises' more theoretical works on various themes of monetary theory and policy,¹ comparative economic systems – capitalism, socialism, and interventionism² – the general nature and workings of the market economy, or the methodology and philosophy of the social sciences,³ most of these

¹ Ludwig von Mises, *The Theory of Money and Credit* (Indianapolis, IN: Liberty Classics [1912; 3rd revised ed., 1953] 1981); and "Monetary Stabilization and Cyclical Policy [1928] in *The Causes of the Economic Crisis, and Other Essays Before and After the Great Depression* (Auburn, AL: Ludwig von Mises Institute, 2006), pp. 53-153.

² Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (Indianapolis, IN: Liberty Classics [1922; 3rd revised ed., 1951] 1981); *Liberalism: The Classical Tradition* (Indianapolis, IN: Liberty Fund, [1927] 2005); *Critique of Interventionism* (Irvington, NY: Foundation for Economic Education, [1929] 1996); *Interventionism: An Economic Analysis* (Irvington, NY: Foundation for Economic Education [1940] 1996); *Bureaucracy* (New Haven, CT: Yale University Press, 1944); and *Planning for Freedom, and Other Essays* (South Holland, Ill: Libertarian Press [1951] 1980).

³ Ludwig von Mises, *Epistemological Problems of Economics* (New York: New York University Press [1933] 1981); *Human Action: A Treatise on Economics* (Irvington, NY: Foundation for Economic Education, [1949, 3rd revised ed., 1966] 1996); *Theory and History: An Interpretation of Social and Economic Evolution* (Auburn, AL: Ludwig von Mises Institute [1957] 1985); and *The Ultimate Foundations of Economic Science* (Irvington, NY: Foundation for Economic Education [1962] 2002).

articles and lectures (like the ones in volume 2 and 3 in this series)⁴ offer a different perspective of Mises as an applied economist. Here is not the broad theorist concerned, often, with stepping back from the particular details of specific historical circumstances to investigate and evaluate the essential and universal properties of human action; or the institutional prerequisites for economic calculation and the rational allocation of resources among competing ends; or the relationships between time preference, investment time horizons, monetary expansion, and the sequential stages of the business cycle.⁵

Instead, these essays investigate and analyze the historical and institutional workings of the pre-World War I monetary system of the Austro-Hungarian Empire, and the issues surrounding legal specie redemption for the bank notes of the Austro-Hungarian Bank; the politics behind the establishment of the gold standard in Austria-Hungary; the growing fiscal imbalances developing in the Habsburg Empire due to the patterns of government spending and taxing policies in the first decade of the twentieth century; and the reasons behind the economic crisis that hit Austria-Hungary in the years immediately before the start of the Great War.

⁴ Richard M. Ebeling, ed., *Selected Writings of Ludwig von Mises*, Vol. 2: *Between the Two World Wars: Monetary Disorder, Interventionism, Socialism and the Great Depression* (Indianapolis, IN: Liberty Fund, 2002); *Selected Writings of Ludwig von Mises*, Vol. 3: *The Political Economy of International Reform and Reconstruction* (Indianapolis, IN: Liberty Fund, 2000).

⁵ On Mises' life and contributions to economics in general and the philosophy of freedom, see, Richard M. Ebeling, *Austrian Economics and the Political Economy of Freedom* (Northampton, MA: Edward Elgar, 2003), Ch. 3, "A Rational Economist in an Irrational Age: Ludwig von Mises," pp. 61-100; and, Richard Ebeling, *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition* (London/New York: Routledge, 2010); also, Murray N. Rothbard, *Ludwig von Mises: Scholar, Creator, Hero* (Auburn, AL: Ludwig von Mises Institute, 1988); Israel M. Kirzner, *Ludwig von Mises* (Wilmington, DE: ISI Books, 2001); and, Jörg Guido Hülsmann, *Mises: The Last Knight of Liberalism* (Auburn, AL: Ludwig von Mises Institute, 2007).

Here, too, we see Mises analyzing during the war the motives behind German and Austro-Hungarian trade policy; the impact and significance of emigration from the Austria; the effects from the monetary inflation used to fund the government's war expenditures; and the pros and cons of financing those war expenditures through taxation versus borrowing by the issuance of war bonds.

After the war, Mises explains the distorting effects from the new Austrian government's control and rationing of foreign exchange for imports and exports; the impact on the Austrian foreign exchange rate due to monetary expansion to finance the government's huge deficit spending; a specific policy agenda to bring the country's financial house back into order, and the need for cooperation from both businesses and labor unions if this was to be achieved without Austria's currency collapsing into a hyperinflation; the claims that holders of bank notes of the old Austro-Hungarian Bank could make on the new Austrian National Bank in the postwar period; Austria's fiscal problems in the period after the end of the inflation; and the lessons for banking reform after the collapse of several banks in 1931.

Ludwig von Mises became immersed in these issues because of the circumstance that he had to earn a living outside the Austrian academic arena. University teaching appointments were few and far between in Austria both before and after the First World War, even though Mises was clearly qualified for such a position.⁶ His only formal relationship with the University of Vienna, after

⁶ For Friedrich A. Hayek's explanation for Mises' failure to obtain a formal academic position, see, Peter G. Klein, ed., *The Collected Works of F. A. Hayek, Vol. IV: The Fortunes of Liberalism, Essays on Austrian Economics and the Ideal of Freedom* (Chicago: University of Chicago Press, 1992) pp. 127-128. While anti-Semitism may have played a part in Mises not being offered a position at the University of Vienna, Hayek believed that it was mostly due to Mises' uncompromising and out

graduating in 1906 with a doctoral degree in jurisprudence,⁷ was as a *privatdozent* (an unsalaried lecturer), which permitted him the privilege to offer seminars during the academic year. Mises offered such a seminar almost every term from 1913 to 1934 (except for most of the time during the Great War). He was promoted to *Professor Extraordinary* in May 1918, but this was a purely honorific title that was still unsalaried and with a nominal “tenure” as a professor in this status.⁸

However, beginning in 1920 until the spring of 1934, Mises organized and chaired a *privatseminar* (private seminar) of interested scholars in the fields of economics, history, sociology, political science, and philosophy. It met twice a month between October and June on Friday evenings at 7 p.m. at his office at the Vienna Chamber of Commerce. The private seminar came to an end when Mises accepted a full-time teaching position at the Graduate Institute of International Studies in Geneva, Switzerland as Professor of International Economic Relations beginning in the autumn of 1934.⁹

spoken criticism of socialism at a time that the intellectual community of Vienna was heavily dominated by “the Left.”

⁷ Training as an economist was received through the faculty of law at the University of Vienna.

⁸ He was also permitted to serve as a chair on dissertation committees and was regularly called upon to participate as a faculty participant at graduate student oral defenses of their thesis. For example, the book by Fritz Machlup on the gold-exchange standard that Mises discusses in chapter 22 of this volume was Machlup’s dissertation under Mises’ supervision at the University of Vienna. And he was on the faculty committee that questioned Alfred Schutz, the later internationally known sociologist and phenomenological philosopher, when he defended his thesis at the University of Vienna.

⁹ See, Ch. 30 in this volume for Mises’ last paper presented at his private seminar, on, “Maxims for the Discussion of the Methodological Problems of the Social Sciences,” in March 1934. Many of those who participated in the seminar recalled in later years that they considered it to be one of the most rewarding and challenging intellectual experiences of their lives because of the consistent quality of the papers delivered and the discussions that followed. For accounts of the seminar by some of the participants, see, Ludwig von Mises, *Memoirs* (Auburn, AL: Ludwig von Mises Institute [1940] 2009), pp. 81-83, and the recollections of other members of the seminar in the appendix to, Margit von Mises, *My Years with Ludwig von Mises* (Cedar Falls, Iowa: Center for Futures Education, 2nd, ed. 1984) pp. 201-210.

As a result of an academic career being closed off to him, from 1909 to 1934, Mises made his living as an economic advisor and policy analyst for the Vienna Chamber of Commerce, Crafts, and Industry. First hired as an assistant for the drafting of documents, in 1910 he was promoted to deputy secretary. When he returned from active duty in the First World War, he was made “first secretary” at the Chamber responsible for matters relating to a wide variety of areas including monetary and fiscal affairs, trade and financial issues, and administrative and constitutional law.

He developed and refined his skills as an economist having to deal with the everyday practical affairs and policy issues of the Austria of his time. He had to master and maintain a thorough and extremely detailed knowledge of the Austrian economy, and the impact of Austrian government policy on the industrial, commercial, and monetary and fiscal affairs of the country.¹⁰ As Mises expressed it years later in his *Memoirs*:

My job with the *Handelskammer* [the Chamber of Commerce] greatly expanded my horizons. That I now have the material for a social and economic history of the downfall of the Austrian civilization readily at hand is to a great degree the result of the studying that was required of me to be able to carry on with my work in the *Handelskammer*.
Travels that led me to all parts of old Austria-Hungary from 1912-

¹⁰ For a detailed discussion of Mises’ policy writings and work at the Vienna Chamber of Commerce in the interwar period, see, Richard M. Ebeling, *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition* (London/New York: Routledge, 2010), Ch. 5: “The Economist as the Historian of Decline: Ludwig von Mises and Austria between the Two World Wars,” pp. 88-140; and for many of Mises’ articles and Chamber of Commerce policy pieces during the 1920s and 1930s, see, Richard M. Ebeling, ed., *Selected Writings of Ludwig von Mises*, Vol. 2: *Between the Two World Wars: Monetary Disorder, Interventionism, Socialism and the Great Depression*.

1914 taught me much in particular. In visiting the centers of industry, my intent was to become acquainted with the industrial situation in view of the renewal of customs and trade relations with Hungary, and the adoption of new, autonomous tariffs and trade treaties.

The main thrust of my job with the *Handelskammer* was not dealing with commercial questions, but those pertaining to finance, currency, credit, and tax policy. In addition, I was given special assignments on an ongoing basis. From the time of the armistice until the signing of the Peace Agreement of Saint Germain [in September 1919] I was the consultant on financial questions to the Foreign Office. Later, when the terms of the peace treaty was put into effect, I was in charge of the office concerned with the prewar debt. In this capacity I had numerous dealings with the representatives of our former enemies. I was the Austrian delegate to the international *Handelskammer* [the International Chamber of Commerce] and a member of many international commissions and committees, whose insoluble task it was to facilitate the peaceful exchange of goods and services in a world pervaded by national hatred and the precursors of genocide.¹¹

At a relatively early age Mises seems to have formulated in his mind a rather comprehensive classical liberal worldview of the social order. His experience in the role of applied economist clearly left its mark and influenced his understanding of the effects that government intervention could have on the effective functioning of a modern market economy. To appreciate this, and the writings included in his volume, it is necessary to take a glance at the political and economic environment of

¹¹ Ludwig von Mises, *Memoirs*, pp. 63-64; also, see, on Mises' work at the Chamber, Alexander Hörtelehner, "Ludwig von Mises und die Österreichische Handelskammerorganisation" ["Ludwig von Mises and the Chamber of Commerce"] *Wirtschaftspolitische Blätter* No. 28 (1981) pp. 140-150.

the old Austro-Hungarian Empire, and the Austrian monetary system as it developed in the nineteenth century.

The Habsburg Monarchy and the Austro-Hungarian Empire¹²

The House of Habsburg, which came to rule a vast empire for nearly eight hundred years, had its origin in the thirteenth century. Through a series of royal marriages, treaties and some conquests, the Habsburg Monarchy gained control over a large territory in Central and Eastern Europe, and for a period of time large areas in Western Europe, as well, including Spain, parts of modern-day France, Italy, Germany, and Switzerland, and what later became Holland, Belgium, Luxemburg. From the thirteenth century to the middle of the nineteenth century, the Habsburgs also nominally headed the Holy Roman Empire, or its later, loose German Confederation.

¹² The following summary of the history of the Habsburg Empire is drawn from, Henry Wickham Steed, *The Hapsburg Monarchy* (New York: Howard Fertig [1914] 1969); Oscar Jaszi, *The Dissolution of the Habsburg Monarchy* (Chicago: University of Chicago Press, 1929); A. J. P. Taylor, *The Habsburg Monarchy, 1809-1918: A History of the Austrian Empire and Austria-Hungary* (Chicago: University of Chicago Press, [1948] 1976); Arthur J. May, *The Hapsburg Monarchy, 1867-1918* (Cambridge: Harvard University Press, 1951); Arthur J. May, *The Passing of the Hapsburg Monarchy, 1914-1918* (Philadelphia: University of Pennsylvania Press, 1966); Robert A. Kann, *The Multinational Empire: Nationalism and National Reform in the Habsburg Monarchy, 1848-1918*, 2 Vols. (New York: Columbia University Press, 1950); Robert A. Kann, *A History of the Habsburg Empire, 1526-1918* (Berkeley: University of California Press, 1974); Hans Kohn, *The Habsburg Empire, 1804-1918* (New York: D. Van Nostrand, 1961); Edward Crankshaw, *The Fall of the House of Habsburg* (New York: The Viking Press, 1963) C. A. Macartney, *The Habsburg Empire, 1790-1918* (New York: Macmillan, 1969); Gordon Brooks-Shepherd, *The Austrians, A Thousand-Year Odyssey* (New York: Carroll & Graf, 1996); and Robin Okey, *The Habsburg Monarchy: From Enlightenment to Eclipse*: (New York: St. Martin's Press, 2001).

It was during this time, when the Habsburgs were beginning to dominate so much of Europe, that Emperor Frederick III (1415-1493) had inscribed on official buildings the five vowels, A E I O U, which he interpreted as, “Alles Erdreich is Osterreich untertan” (“All the earth is subject to Austria”), or in the Latin, “Austriae Est Imperare Orbi Universo” (“Austria must rule the universe”).¹³

The Habsburg’s ruled as absolute monarchs. But under the influence of the Age of Enlightenment and the early phase of the French Revolution, first Empress Maria Theresa (1717-1770) and then her sons, Joseph II (1740-1790) and Leopold II (1747-1792) attempted to introduce various forward-looking reforms while retaining the principle of absolutism. The dark turn taken in the French Revolution and the rise of Napoleon to power shifted the monarchy back in a far more conservative direction under Francis II (1768-1835). With Napoleon’s victories over the German states, the Holy Roman Empire was dissolved and Francis II declared himself Emperor of Austria in 1804.

As one of the final victors over the French after Napoleon’s defeat in Russia in 1812, the Habsburg Empire in Central and Eastern Europe was consolidated following the Congress of Vienna in 1815 as one contiguous territory that by the 1880s incorporated what on a map of Europe, today, included Austria, Hungary, the Czech Republic, Slovakia, Slovenia, Croatia, Bosnia, and large parts of Italy, Poland, Ukraine and Romania.

In the years just preceding the First World War, the Austro-Hungarian Empire covered a territory about 415,000 square miles and included within its

¹³ See, Hans Kohn, *Not by Arms Alone: Essays on Our Time* (Cambridge: Harvard University Press, 1940), Ch. 3: “The Problem of Central Europe: The Legacy of the Habsburgs,” pp. 43-64.

borders a dozen or so national and linguistic groups including Germans, Hungarians, Czechs, Slovaks, Croatians, Romanians, Italians, Poles, Bulgarians, Serbians, Slovenians, and Ruthenians. Out of a population of 50 million the Germans and Hungarians each numbered about 10 million, with the remaining 30 million made up of these other groups.

The Europe of the nineteenth century experienced a relentless battle between four powerful ideas: monarchical absolutism, political and economic liberalism, integral nationalism, and revolutionary socialism. Absolutism insisted upon the divine rights of kings to rule without restraint; liberalism demanded the recognition of individual liberty, representative and limited constitutional government, and freedom of private enterprise from state control; integral nationalism (by the middle decades of the nineteenth century) increasingly insisted upon the unification and political independence of peoples sharing a common language, culture and history, and finally a common ethnicity or race;¹⁴ and socialism called for the overthrow of private property, nationalization of the means of production, and greater economic and social equality by either violent or democratic methods.

All four of these ideological forces were at work in the Habsburg Monarchy until the end of the Austro-Hungarian Empire in the ruins of the First World War.

¹⁴ On the development and evolution of the nationalist idea in the nineteenth century, see, G. P. Gooch, *Nationalism* (New York: Harcourt Brace & Howe, 1920); Carlton J. H. Hayes, *The Historical Evolution of Modern Nationalism* (New York: Richard R. Smith, 1931); Walter Sulzbach, *National Consciousness* (Washington, D.C.: American Council on Public Affairs, 1934); Frederick Hertz, *Nationality in History and Politics* (New York: Oxford University Press, 1944); Hans Kohn, *Nationalism: Its Meaning and History* (Princeton, NJ: D. Van Nostrand, 1955) and Hans Kohn, *Nationalism and Realism: 1852-1879* (Princeton, NJ: D. Van Nostrand, 1968).

The French Revolution of February 1848 reverberated across much of Europe, including in the Austrian Empire. Within days and weeks of the uprising in Paris, students on the streets of Vienna demanded constitutional change and the Italians and Hungarians were in open revolt against their Habsburg rulers. By the end of 1849, however, the Italians and Hungarians were crushed (the latter through the intervention of the Russian Imperial Army) and Habsburg rule was once more imposed with especial ruthlessness against the Hungarians.

At first reforms were promised to the Austrian liberals, with a constitution promised in July 1848. And when eighteen-year-old Francis Joseph (1830-1916) assumed the throne upon the abdication of his uncle, Ferdinand I (1793-1875), in December 1848, the new Emperor gave his support to the constitutional changes.¹⁵ Almost immediately, however, he reversed himself and insisted upon the reassertion of absolutist authority. What Francis Joseph had inherited from his ruling ancestors was a belief in “his divine right of unlimited monarchical power,” tempered with the idea “that his rule must, before all, produce the best possible results for the peoples of his realm . . . Yet, up to the end he did not doubt that his empire, composed of so many different races and lands, could be governed successfully only by a hereditary monarch and according to his absolute will.”¹⁶ Thus, he could not make the concessions

¹⁵ On the life and reign of Francis Joseph, who ruled over the empire for sixty-eight years, see, Joseph Redlich, *Emperor Francis Joseph of Austria* (New York: Macmillan, 1929); and Alan Palmer, *Twilight of the Habsburgs: The Life and Times of Emperor Francis Joseph* (New York: Grove Press, 1994).

¹⁶ Joseph Redlich, “The End of the House of Austria,” *Foreign Affairs* (July 1, 1930). p. 605; see, also, Hans Kohn, *The Habsburg Empire, 1804-1918* p. 49: “Like a good eighteenth century monarch, [Francis Joseph] regarded himself as the first servant of the nation, but he identified the nation with himself and his dynasty. He worked indefatigably for the good of his people, but they were *his* people and he interpreted what was good for them.”

that would have undermined his absolute rule in the name of caring for the well being of his subjects.

Neither could he completely concede to the increasing nationalist sentiments of the diverse peoples in his large realm without, also, abdicating his responsibility as that benevolent ruler. Many Austrian liberals who lived a good portion of their lives under the reign of Francis Joseph believed that he twice missed the opportunity to successfully transform his multinational empire into a federal domain that might have reconciled the conflicting interests and demands of the national groups under his rule. The ideal of these liberals from the middle of the nineteenth century to the First World War had been the conception of what some of them called “the Austrian idea.” If a federal structure of government could have been set up in which each of these peoples had wide political and social autonomy within their own lands, while sharing a common bond of economic freedom and civil liberties, the Habsburg monarchy could have created on a larger and far grander scale what had been formed in the Swiss confederation with its reconciliation and harmony among its French, German, and Italian-speaking citizens.¹⁷

Francis Joseph’s rejection of constitutional reforms and the reimposition of central authority over the Italians, Hungarians, and his Slav subjects in 1848-1849 was the first chance lost for any such reconciliation. The second lost opportunity occurred following his defeat at the hands of the Prussians in 1866, when Bismarck pushed Austria out of the German Confederation. Fearful of the Hungarians taking advantage of the

¹⁷ On the mutual benefits to be derived from a state that incorporates a variety of different national groups, see the classic essay by Lord Acton, “Nationality,” [1862] in J. Rufus Fears, ed., *Selected Writings of Lord Acton*, Vol. I: *Essays in the History of Liberty* (Indianapolis, IN: Liberty Classics, 1985) pp. 409-433; for a contrary view as to why such a Swiss-type solution to the nationalist tensions of the Austro-Hungarian Empire was not feasible, see, Benedetto Croce, *History of Europe in the Nineteenth Century* (New York: Harcourt, Brace, 1933) pp. 181-186.

Empire's postwar weakness to claim full independence through another violent uprising, Francis Joseph agreed to the *Ausgleich*, the "Compromise," of 1867 that transformed the Austrian Empire into the Austro-Hungarian Empire. While Francis Joseph remained Emperor of both halves of his domain, Hungary became widely independent in many of its domestic affairs. Only a common customs and monetary system and a shared military and foreign policy completely linked Hungary to the Austrian "Crownlands" directly ruled by Francis Joseph's government in Vienna.¹⁸

As Hans Kohn, one of the twentieth century's leading experts on the history and philosophy of nationalism, and who had grown up under the rule of Francis Joseph in Prague, explained, "In the Compromise with the Hungarian nobility in 1867, the aspirations of the Czechs, Slovaks, Serbs, Croats, and Romanians, who in large majority were then still loyal to the dynasty, were sacrificed for the purpose of winning the assent of the Magyars to a common foreign and military policy on the part of what now became the Dual Monarchy"¹⁹ Indeed, at first, several leading Czech and Hungarian nationalist leaders believed that the flowering of their people's cultural and linguistic identities could best flourish in the wider setting of a multinational Habsburg Empire. But as the nineteenth century progressed this sentiment shifted into a belief that only national independence could secure these goals.

A far more liberal-minded voice in the Habsburg family was Francis Joseph's son, Crown Prince Rudolf (1858-1889), the heir to the throne. Among his personal tutors had been Carl Menger (1840-1921), the founder of the Austrian School of Economics.

¹⁸ The Habsburg "Crownlands" directly under the Emperor's authority was made up of the territory of present-day Austria, Bohemia and Moravia (the present-day Czech Republic), Galicia and Bukovina (now part of western Ukraine), Slovenia, Dalmatia (along part of the Adriatic seacoast), and the southern Tyrol (now part of northern Italy); Bosnia was ruled as a separate administrative entity.

¹⁹ Hans Kohn, "The Viability of the Habsburg Monarchy," *Slavic Review* (March 1963), p. 38.

Under Menger's guidance, Crown Prince Rudolf had become well versed in the free trade and relatively *laissez-faire* ideas of the Classical Economists.²⁰ Menger also had co-authored with Rudolf a scathing criticism of the Austrian nobility, who were accused of having lost their sense of social duty and, instead, had escaped into frivolous court intrigues, pointless social entertainments, and financial irresponsibility. It was a clear call for recognition of and respect for the middle-class values of enterprise, frugality and personal responsibility. The bourgeois virtues needed to replace the anachronistic role of the aristocracy in society, who had lost their way in the pretensions of power and lure of wasteful pleasures.²¹ But whatever influence the Crown Prince might have had on the course of events in Austria-Hungary was cut short by his suicide in 1889 at his hunting lodge at Mayerling.²²

The particularly nationalist imperialism of the Hungarians against the other peoples under their control was not the only problem as the nineteenth century progressed in terms of growing antagonism among the subject peoples in the Dual Monarchy. The German-Austrians, also, increasingly became defensive and antagonistic against the rising nationalist aspirations of the Czechs, Poles, Slovenians and others in the Crownlands, as well as against the growing demands of the Hungarians for independence.

²⁰ See, Erich W. Streissler and Monika Streissler, eds., *Carl Menger's Lectures to Crown Prince Rudolf of Austria* (Northampton, MA: Edward Elgar, 1994).

²¹ Crown Prince Rudolf and Carl Menger, "The Austrian Nobility and Its Constitutional Vocation: A Warning to Aristocratic Youth" [1878] in Eugene N. Anderson, Stanley J. Pinceti, and Donald J. Siegler, eds., *Europe in the Nineteenth Century, a Documentary Analysis of Change and Conflict*, Vol. II: 1870-1914 (Indianapolis, IN: Bobbs-Merrill, 1961) pp. 78-101.

²² See, Richard Barkeley, *The Road to Mayerling: The Life and Death of Crown Prince Rudolph of Austria* (New York: Macmillan, 1958); and Judith Listowel, *A Habsburg Tragedy: Crown Prince Rudolph* (New York: Dorset Press, 1978). Rudolph's domestic liberalism, however, was combined with support for Austrian foreign policy imperialism; see, Robert A. Kann, *The Multinational Empire*, Vol. 2, pp. 181-187.

As Hans Kohn pointed out, “The spread of democracy, literacy, and economic well-being in the western half of the monarchy after 1867 strengthened the non-German nationalities there at the expense of the Germans. The result was that many Germans in the monarchy lost their faith in an Austrian idea as much as many Slavs and other non-Germanic peoples did . . . By the end of the nineteenth century many Austrian Germans looked to the Prussian German Reich as their real home and venerated [Otto von] Bismarck.”²³

Looking back at the events that brought about the demise of the Habsburg Empire in the immediate aftermath of the First World War, Ludwig von Mises explained why many German-Austrians turned against liberalism as a foundation for the preservation of the monarchy and the Austro-Hungarian state. Over the centuries German-Austrian settlers had made their homes in the eastern reaches of the Empire. They brought with them the German language, culture, literature, commercial knowledge and knowhow. They viewed themselves as a “civilizing force” among the lesser-advanced nationalities, especially among the Slavic peoples.

And, indeed, many of these subject peoples became acculturated into German-Austrian life, since the latter was the dominant group; the German language in particular became the venue for social and economic advancement. But as literacy and national consciousness awakened among these other peoples in the nineteenth century, loyalties to and identification with German-Austria and the Hapsburg dynasty were replaced with a growing allegiance and sense of belonging to their own ethnic and linguistic groups.

²³ Hans Kohn, “The Viability of the Habsburg Monarchy,” *Slavic Review* (March 1963), p. 39.

Furthermore, birth rates were higher among these peoples than that among the Germans living among them. Cities and towns that had been settled and predominantly populated by Germans for centuries became increasingly Czech or Hungarian, or Polish or Romanian, or Slovenian communities. German-Austrians found themselves shrinking minorities in lands that they long considered to be their own politically, culturally, and commercially. This was especially true in the Czech lands with Prague at its center.

As the nineteenth century progressed, German-Austrians discovered that adherence to liberal principles of representative government and full individual and cultural equality before the law meant the demise of these German communities sprinkled across the Hapsburg domains. For many German-Austrian liberals the choice was between a liberalism that would logically mean the decentralization and possible eventual break-up of the Empire along nationalist lines, or advocacy of centralized political control, monarchical dictate when required, and subversion of democratic aspirations among the non-German peoples.

The first course meant the eventual loss of German political and culture domination in the non-German lands; the second meant holding on to both political and cultural power as long as possible in the non-German areas of the Empire, but only by increasingly alienating the other subject peoples. As Mises explained, part of the German-Austrian tragedy was that national and linguistic imperialism won over liberal idealism.²⁴

What enabled the Habsburg Empire to endure for fifty years after the establishment of the Dual Monarchy in 1867 was the constitutional order that had been

²⁴ Ludwig von Mises, *Nation, State, and Economy: Contributions to the Politics and History of Our Time* (Indianapolis, IN: Liberty Fund, [1919] 1983) pp. 88-109.

implemented at the same time as the *Ausgleich* (or, “Compromise”). The Constitution of 1867, which accompanied the creation of “Austria-Hungary,” was imbued with the spirit of the classical liberal ideas that were then at their zenith in Europe.²⁵ Every subject of the Habsburg Emperor was guaranteed freedom of religion, language, association, profession and occupation, and could appeal to a special higher court of law if a violation of these rights had occurred. Any subject might live wherever he chose throughout the Emperor’s domain. Private property was secure and relatively free trade prevailed within the boundaries of the Empire, though protectionist barriers to international trade continued to be practiced and grew in various ways in the last decades of the nineteenth and first decade of the twentieth centuries.²⁶

The economic free trade zone that made up the Austro-Hungarian Empire served to successfully foster significant economic development beginning and, especially, after the 1880s, though very far from matching the economic progress in Western Europe or in Imperial Germany after 1871.²⁷ However, various forms of government controls and

²⁵ See, Hans Kohn, *The Habsburg Empire, 1804-1918*, p. 72: “Amidst all the controversies and upheavals caused by the growing conflict of nationalities and by the vain search for an Austrian idea, the Austrian Constitution of December 31, 1867, which was a document of mid-century liberalism, remained in force for over half a century.” The Fundamental Law Concerning the General Rights of Citizens from the Austrian Constitution of 1867 may be found at: <http://www.h-net.org/~habsweb/sourcetexts.auscon.htm>. However, see, Robert S. Wistrich, *The Jews of Vienna in the Age of Franz Joseph* (New York: Oxford University Press, 1989) p. 151: “[Adolf] Fischhof put his finger on the central contradiction of the 1867 Constitution – that Austria-Hungary was a multinational state masquerading under liberal German hegemony as a nation-state on the Western European model. It had a dual personality, liberal with regards to the rights of the individual but oppressive in its relation to the Slav nationalities who were treated as ‘servant peoples.’” Adolf Fischhof (1816-1893) was a prominent figure in the Austrian Revolution of 1848, and an outspoken liberal in support of autonomy for the various subject nationalities in the Austro-Hungarian Empire.

²⁶ In 1867, for example, the Lower Austrian Chamber of Commerce located in Vienna declared, “The state has fulfilled its task if it removes all obstacles to the free, orderly activity of its citizens. Everything else is achieved by the considerateness and benevolence of the factory owners and above all by the personal efforts and thriftiness of the workers.” See, Robin Okey, *The Habsburg Monarchy: From Enlightenment to Eclipse*, p. 206.

²⁷ See, David Good, *The Economic Rise of the Habsburg Empire, 1750-1914* (Berkeley: University of California Press, 1984).

regulations began to be domestically superimposed on the society, including the nationalization of the railways, starting in the 1880s. As a result, the remaining history of the monarchy was one of liberal freedoms introduced in 1867 being undermined by nationalist discord, periods of rule by central government decree, and the continuation or introduction of interventionist policies that merely intensified the antagonisms among the subject peoples. As A.J.P. Taylor explained:

In another way, the Austrian state suffered from its strength: it never had its range of activity cut down during a successful period of *laissez-faire*, and therefore the openings for national conflict were far greater. There were no private schools or hospitals, no independent universities; and the state, in its infinite paternalism, performed a variety of services from veterinary surgery to the inspecting of buildings. The appointment of every schoolteacher, of every railway porter, of every hospital doctor, of every tax collector, was a signal of national struggle. Besides, private industry looked to the state for aid from tariffs and subsidies; these, in every country, produce 'log-rolling,' and nationalism offered an added lever with which to shift the logs. German industries demanded state aid to preserve their privileged position; Czech industries demanded state aid to redress the inequalities of the past. The first generation of national rivals had been the products of universities and fought for appointments at the highest professional level; their disputes concerned only a few hundred state jobs. The generation that followed them was the result of universal elementary education and fought for the trivial state employment that existed in every village; hence, the more popular national conflicts at the end of the century.²⁸

²⁸ A. J. P. Taylor, *The Habsburg Monarchy, 1809-1918: A History of the Austrian Empire and Austria-Hungary*, p. 173.

Yet, in spite of all this, and the international tensions and foreign policy fiascos that would eventually plunge Austria-Hungary and the rest of Europe into the calamitous caldron of conflict in 1914, the Habsburg Monarchy succeeded in generating a cosmopolitan culture, especially in Vienna, that brought all the subject peoples together and fostered an inspiring and flourishing world of the arts, music, literature, philosophy, the humanities, and the sciences.²⁹

It made many who lived in the postwar period of rising totalitarianism in the 1920s and 1930s have a deep nostalgia for what seemed a far more civilized and humane epoch in turn-of-the-century Vienna. One voice that attempted to capture this “lost world” was that of Stefan Zweig (1881-1942), a renowned Austrian novelist and essayist who fled Vienna in 1934 and committed suicide in Brazil during the Second World War out of despair for all that was happening in the European world that he had known. In his posthumous work, *The World of Yesterday*, he said:

One lived well and easily and without cares in that old Vienna . . . “Live and let live” was the famous Viennese motto, which today still seems to me more humane than all the categorical imperatives, and it maintained itself throughout all classes. Rich and poor, Czechs and Germans, Jews and Christians, lived peaceably together in spite of occasional chafing, and even the political and social movements were free of the terrible hatred which has penetrated the arteries of our time as a poisonous residue of the First World War. In the old Austria they still strove chivalrously, they abused each other in the news and in the parliament, but at the conclusion of their ciceronian tirades the selfsame representatives sat down together

²⁹ See, William M. Johnson, *The Austrian Mind: An Intellectual and Social History, 1848-1938* (Berkeley: University of California Press, 1972); Allan Janik and Stephen Toulmin, *Wittgenstein's Vienna* (Chicago: Ivan R. Dee, 1973) Carl E. Schorske, *Fin-de-Siecle Vienna: Politics and Culture* (New York: Alfred A. Knopf, 1980); Hilde Spiel, *Vienna's Golden Autumn, 1866-1938* (New York: Weidenfeld & Nicolson, 1987); Paul Hofmann, *The Viennese: Splendor, Twilight, and Exile* (New York: Doubleday, 1988)

in friendship with a glass of beer or a cup of coffee, and called each other Du [the “familiar” in the German language]. . . . The hatred of country for country, for nation for nation, of one table for another, did not yet jump at one daily from the newspaper, it did not divide people from people and nations from nations; not yet had every herd and mass feeling become so disgustingly powerful in public life as today. Freedom in one’s personal affairs, which is no longer considered comprehensible, was taken for granted. One did not look down upon tolerance as one does today as weakness and softness, but rather praised it as an ethical force For the genius of Vienna – a specifically musical one – was always that it harmonized all the national and lingual contrasts. Its culture was a synthesis of all Western cultures. Whoever lived there and worked there felt himself free of all confinement and prejudice.³⁰

For Zweig, thinking back on that bygone paradise, “It was sweet to live here, in this atmosphere of spiritual conciliation, and subconsciously every citizen became supernational, cosmopolitan, a citizen of the world.”³¹

It was, of course, only an illusion. That twilight of the liberal era in the old Austro-Hungarian Empire about which Zweig was so nostalgic had never been as pure and perfect as his mind recalled it. It was certainly true that liberal ideals had been established in the constitution of 1867, and that they were implemented and enforced for the most part, especially in the Crownlands more directly under Emperor Francis Joseph’s imperial authority. But beneath the surface of tolerance, civility, and cosmopolitanism were all the undercurrents of racial and nationalist bigotry, economic collectivism, and political authoritarianism that poured forth

³⁰ Stefan Zweig, *The World of Yesterday* (New York: The Viking Press, 1943), pp. 24-25.

³¹ Ibid., p. 13; see, also, Richard M. Ebeling, “1914 and the World We Lost,” *The Freeman: Ideas on Liberty* (June 2004) pp. 2-3.

like destructive lava from an exploding volcano during and in the aftermath of the First World War.

The Austrian Monetary System, 1867-1914³²

A leading theme of Mises' articles in the first part of this volume concerns the reasons for and the resistance to the full implementation of a gold standard in Austria-Hungary. His arguments in these essays can be better understood against the backdrop of Austria's monetary policies and experiences during the nineteenth century leading up to the currency reform act of 1892.

The story of the Austrian currency in the late eighteenth century and the first two-thirds of the nineteenth century is one of almost continual financial mismanagement. The government would debase the currency to cover its expenses, followed by promises to put its budget on a sound footing, only to see another crisis arise requiring once again turning the handle on the monetary printing press.³³

³² Part of the discussion in this section draws upon, Richard M. Ebeling, *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition*, Ch. 4: "Austria-Hungary's Economic Policies in the Twilight of the 'Liberal' Era: Ludwig von Mises' Writings on Monetary and Fiscal Policy Before the World War I," pp. 57-87.

³³ The following brief account of the history of the Austrian currency is primarily taken from, Charles A. Conant, *A History of Modern Banks of Issue*, 5th ed. (New York G. P. Putnam's Sons, 1915) pp. 219-250; J. Laurence Laughlin, *History of Bimetallism in the United States* (New York: Appleton, 1898), pp. 189-197 & 331-337; Robert Zuckerkandl, "The Austro-Hungarian Bank" in *Banking in Russia, Austro-Hungary, the Netherlands, and Japan* (Washington, D.C. Government Printing Office, 1911) pp. 55-118. Also, specifically on the currency reform of 1892 and its implementation, "The Gold Standard in Austria" [Translation of the Report of the Special Currency Commission to the Upper House of the Austrian Parliament], *Quarterly Journal of Economics* (January 1893), pp. 225-254; "Reform of the Currency in Austria-Hungary," *Journal of the Royal Statistical Society* (June 1892) pp. 333-339; Friedrich von Wieser, "Resumption of Specie Payments in Austria-Hungary," *Journal of Political Economy* (June 1893) pp. 380-405; and Wesley C. Mitchell, "Resumption of Specie Payments in Austria-Hungary," *Journal of Political Economy* (December 1898) pp. 106-113.

The Austrian government made several experiments with state-chartered banks in the 1700s. But each of these Banks soon collapsed or was closed due to lack of public confidence following large quantities of paper monies being issued to cover government expenditures. These expenditures reached huge proportions during the long years of war between the Austrian Empire and first Revolutionary and then Napoleonic France.

Between 1797 and 1811, the supply of government paper money increased from 74,200,000 florins to 1,064,000,000 florins, or a 14-fold increase over this period. Not surprisingly, whereas the price of silver coin expressed in paper money was 118 in 1800, it rose to 203 by 1807, then to 500 by 1810, and reached 1,200 by 1811.

The government announced its intention in 1811 to stop the printing presses and issue a new currency that would be converted at the ratio of five old florins for one new florin, with the total amount of paper money in circulation to be reduced to 212,800,000 florins. But the renewal of the war with Napoleon in 1812 resulted in the new currency being increased to 678,716,000 florins by 1816, a near tripling of the “reformed” currency in five years.

With the final defeat of Napoleon, the Austrian government announced that it would use a portion of the war reparations being paid by France to retire about 131,829,900 florins from circulation, leaving the paper money supply outstanding at around 546,886,000 florins. This process was assisted with the establishment of a new National Bank of Austria, with the Bank withdrawing government paper money in circulation in exchange for its own bank notes, until by early 1848, the total currency supply in circulation had been reduced to 241,240,000 florins, or an almost two-thirds reduction in the paper money supply over a thirty-year period. The National Bank, in

February 1848, had silver reserves of about 65,000,000 florins, i.e., an approximate 25 percent specie cover for its outstanding currency in circulation.

But all of these monetary reforms began to unravel with the outbreak of the revolution of 1848, especially the Hungarian revolt against Austrian rule. Within days, panic runs on the Bank reduced its silver reserves to 35,023,000 florins, a 53 percent loss in specie. The Austrian government suspended silver redemption, and banned the exporting of silver and gold. Putting down the revolution forced the government to again borrow heavily from the National Bank. As a result, confidence in the Bank fell so low that in 1849 the government publicly promised to stop borrowing and cease increasing the currency.

But the process started again in a few years with Austria's military mobilization during the Crimean War, and then its wars against Italian nationalists and their French ally in a vain attempt to maintain control of portions of northern Italy. In 1850 government indebtedness to the National Bank had stood at 205,300,000 florins. With the Crimean War of 1854, the government's debt increased to 294,200,000 florins. It was reduced to 145,700,000 florins by 1859. But the start of the Italian campaigns that year pushed it up again to 285,800,000 florins, along with a renewed suspension of specie payments as the public wished to redeem the paper currency representing the value of this enlarged debt.

In 1863, an attempt was made, once again, to introduce a currency reform – the Plener Act – this time along the lines of Great Britain's Peel's Bank Act of 1844. But Austria's disastrous war with Prussia in 1866 pushed the supply of paper money in circulation from 80,000,000 florins before the conflict to 300,000,000 florins at its end.

The Compromise of 1867 that formally created the Austro-Hungarian Empire granted Hungary its own parliament, government, and domestic budget. It established a customs union and a common military and foreign policy between the two parts of the Hapsburg domain, and a monetary union with the Austrian National Bank retaining its monopoly of note issue throughout Francis Joseph's domain. Some of the Hungarian liberals had advocated a system of competitive note-issuing private banks in place of the National Bank, but secret agreements between the Emperor's government and the Hungarian nobility eliminated this as an option.

On July 1, 1878, the Austrian National Bank was transformed into the Austro-Hungarian Bank. The Emperor, under joint nomination of the Austrian and Hungarian parliaments, appointed its Governor. He was assisted by two Vice-Governors – one Austrian and the other Hungarian – appointed by the respective governments. The Bank's operating privileges were renewed in 1887, 1899, and in 1910, with few substantial changes in their detail.

Formally, from 1816, Austria had been on a silver standard. But, as we saw, the Austrian National Bank only maintained unofficial specie redemption for limited periods of time, soon interrupted usually by another war crisis requiring currency expansion to fund the government's expenditures.

The paper currency florin, not surprisingly, traded at a significant discount against the silver coin florin. Between 1848 and 1870, this discount was never less than about 14 percent and was often between 20 and 23 percent. But restrictions on note issuance under the operating rules of the Bank limited the expansion of the supply of bank notes. The provisions of the 1863 Bank Act limited the circulation of "uncovered" florins to

200,000,000. Any amount above that had to be covered by gold or silver coin or bullion. Any additional “uncovered” bank note issuance was subject to a penalty tax against the Bank of 5 percent.

With many of the major governments of Europe and North America establishing or reestablishing their economies on a gold basis in place of silver in the 1870s, the world price of silver began to fall.³⁴ After the Austro-Prussian War of 1866, the government’s pressures on the Bank to fund deficits were greatly reduced, and the Bank could more or less follow the rules against uncovered note issuance. As a result, the paper florin’s discount relative to silver disappeared by 1878. Silver began to flow into Austria-Hungary in such quantities that the Bank was instructed by the government to end the free minting of silver.

The paper florin actually rose to a premium against silver, as a result. As Friedrich von Wieser expressed it, “Silver had become of less value than paper!”³⁵ In addition, the florin was significantly appreciating in value against gold. The price in paper florins for 100 gold florins between 1887 and 1892 was:

Average for the year	Austrian florin notes
1887	125.25
1888	122.87
1889	118.58
1890	115.48

³⁴ For example, following the Franco-Prussian War of 1870-1871, the German Empire was proclaimed, unifying under Prussian leadership the various German states and principalities. In 1871 and 1873, legislation was passed formally putting Imperial Germany on the gold standard. See, *The Reichbank, 1876-1900* (Washington, D. C.: Government Printing Office, 1910).

³⁵ Wieser, “Resumption of Specie Payments in Austria-Hungary,” p. 386.

The major monetary issue, therefore, during these years was to bring a halt to any further increase in the value of the Austrian paper currency. In February 1892, the Austrian and Hungarian governments invited a group of professional and academic experts to meet and address a set of questions relating to: whether a gold standard should be adopted; if so, should it be monometallic or partly bimetallic with silver; what should be the status of government notes in circulation; how should the conversion from the existing florin to a gold standard be undertaken; and what monetary unit should be chosen?

Some of the most illustrious people in the field were brought together to offer their views and opinions on these questions. Thirty years later Ludwig von Mises described them in the following manner:

From March 8 to March 17, 1892 the government-convened Currency Inquiry Commission met in Vienna. The chairman was Finance Minister [Emil] Steinbach; beside him stood the memorable Eugen von Böhm-Bawerk, as section head. Thirty-six experts appeared before the Commission to answer five questions that were posed by the government. No Austrian was left off the list of participants at the inquiry who had anything of importance to say on currency matters. Along with Carl Menger, the founder of the Austrian School of Economics, there was Wilhelm von Lucam, the highly honored long-time General Secretary of the Austro-Hungarian Bank. Moritz Benedikt, the publisher of *Neue Freie Presse* [*New Free Press*]; Theodor Thaussig, the spiritual leader of the Viennese banking world; and Theodor Hertzka, the well-known writer on monetary matters and social policy. The thick quarto volume that makes

up the stenographic minutes of the inquiry remains today a source for the best ideas on all matters relating to monetary policy.³⁶

Virtually all of the participants spoke in favor of Austria's adoption of a gold standard. Menger, for example, at one point said: "Gold is the money of advanced nations in the modern age. No other money can provide the convenience of a gold currency in our age of rapid and massive commodity exchanges. Silver has become a troublesome tool of trade. Even paper money must yield to gold when it comes to monetary convenience in everyday life . . . Moreover, under present conditions only a gold currency constitutes hard money. Neither a bank note and treasury note nor a silver certificate can take the place of gold, especially in moments of crisis."³⁷

Later summarizing the work of the commission, Wieser supported the adoption of the gold standard in colorful language:

Money is like speech; it is a means of intercourse. He who would have dealings with others must speak their language, however irrational he may find it. Language is rational by the very fact that it is intelligible to others, and more rational in proportion as it is intelligible to more people or to all. There can no more be an independent money system than independent speech; indeed, the more universal character of money, as compared with language, appears in this, that while a national language has its justification and significance in the intercourse of the world, there is no place for a national monetary system in the world's intercourse. If Europe

³⁶ Ludwig von Mises, Ch. 19: "The Austrian Currency Problem Thirty Years Ago and Today," in the present volume.

³⁷ Quoted in Hans Sennholz, "The Monetary Writings of Carl Menger," in Llewellyn H. Rockwell, ed., *The Gold Standard: Perspectives in the Austrian School* (Auburn, AL: The Ludwig von Mises Institute [1985] 1992) p. 26; see, also, Günther Chaloupek, "Carl Menger's Contributions to the Austrian Currency Debate (1892) and His Theory of Money," paper presented to the 7th ESHET Conference, in Paris, France, January 30 – February 1, 2003.

errs in adopting gold, we must still, for good or evil, join Europe in her error, and we shall thus receive less injury than if we insist on being “rational” all by ourselves.³⁸

The Currency Commission, in its official report to the Upper House of the Austrian Parliament, was no less adamant that gold, and only gold, was the recognized and essential international money. For that reason Austria-Hungary needed to adopt gold as the nation’s standard if it was to successfully participate in the commerce and trade of the world.³⁹

The Commission proposed and the government accepted that the monetary unit would be renamed the *krone* (the crown), with the new crown being equal to one-half the replaced florin. Standard coins would be gold pieces of 10 and 20 crowns, each one being of 900 parts gold to 100 parts copper. The 20-crown coin would have a full weight of 6.775067 grams, and a fine weight of 6.09756 grams. In 1892 an exchange rate for the crown was fixed at 1.05 Swiss Francs and 0.8505 German Marks.

Silver was kept as a secondary medium of exchange for smaller transactions and limited legal tender status. Government paper money was temporarily kept in circulation up to a certain maximum, but with the expectation of its eventual retirement. For the transition to a full gold standard with legally mandated redemption of bank notes for specie, it was expected that the Austro-Hungarian Bank would continue to accumulate sufficient supplies of gold until at an unspecified date formal redemption would be instituted.

³⁸ Wieser, “Resumption of Specie Payments in Austria-Hungary,” pp. 387-388.

³⁹ “The Gold Standard in Austria,” p. 230.

A legal obligation to redeem crowns for gold was, in fact, never made into law. Yet, from 1896 and most certainly after 1900 up until the outbreak of the war in 1914, the Austro-Hungarian Bank acted as if it now had that obligation and did pay in gold for its bank notes presented for redemption. Indeed, the oversight of this “shadow” gold standard (as it was called) by the Austro-Hungarian Bank, with maintenance of the exchange rate within a margin not much off the “gold points” was praised by authorities at the time as an exemplary case of a highly successful “managed currency.”⁴⁰

Ludwig von Mises’ Writings on Monetary and Fiscal Policy before the Great War

Ludwig von Mises’ earliest writings on monetary and fiscal policy were published between 1907 and 1914,⁴¹ and focused on these currency reform and related issues. He devoted a chapter in his *Memoirs* in explaining the background behind some of these articles.⁴² He details his frustrations when the articles resulted in him coming face-to-face for the first time to opposition by government officials to reasonable and publicly endorsed policies due to political corruption and misappropriation of “secret” slush funds that would be threatened by implementing a fully convertible gold standard.

But he does not go into very great detail about content of these early essays. They may be grouped under two headings. The first consists of articles concerning the political pressures that finally lead to putting Austria formally on the path of a gold standard in 1892, and the reasons for the resistance and delay in legally establishing gold

⁴⁰ More recently, the Austro-Hungarian Bank’s exchange rate policy has been praised as an example of successful “target zone” management of an exchange rate band; see, Marc Flandreau and John Komlos, “Target Zone in History and Theory: Lessons from an Austro-Hungarian Experiment (1896-1914),” Discussion Paper No. 18 (July 2003), Department of Economics, University of Munich, Germany.

⁴¹ Mises was between twenty-six and thirty-two years of age when he wrote these articles.

⁴² Mises, *Memoirs*, pp. 33-42.

convertibility up to the beginning of World War I. The second group deals with fiscal extravagance and the regulatory and redistributive intrusiveness of the Austro-Hungarian government, which was leading the country to a potential financial and economic crisis. Even if the events of the World War had not intervened to accelerate the process that culminated in an end to the more than eight hundred year reign of the Hapsburgs, the growth of the interventionist state was weakening the foundations of the country.

The earliest of these essays is concerned with “The Political-Economic Motivations for the Reform of the Austrian Currency.” It is primarily an analysis of the changing factors influencing various interest groups that finally lead to a sufficient coalition of these interests endorsing the move toward a gold standard. It highlights the fact that a major shift in economic policy is often dependent upon the vagaries of unique historical events, without which such a change might never have the chance to be implemented.⁴³

From 1872 to 1887, the Austrian currency had been depreciating on the foreign exchange market. Many of the agricultural and manufacturing interests in both Austria and Hungary did not object to this trend, since it reduced foreign competition by raising the costs of imports and worked to make Austrian goods more competitive in other countries. But beginning in 1887, the currency began to appreciate, and continued to do so until 1891. The same interests that were quite happy living with a currency loosing

⁴³ For example, the classical economist, Henry Fawcett argued in *Free Trade and Protection* (London: Macmillan 1878) pp. 17-47, that if not for the fact that in the winter of 1845-1846 there had been such a great famine due to the failure of many of the crops and therefore such a large portion of the population in England and Ireland simultaneously threatened with starvation, the pressure for the unilateral repeal of agricultural protectionism (the Corn Laws) might never have otherwise occurred. It was unlikely that the same passion for a radical change to free trade would have been stimulated by the existing industrial and manufacturing protectionism that only affected different, diverse and limited sub-groups of the consuming public.

value were extremely anxious with an appreciating currency that lowered the costs of imports and raised the costs of Austrian exports.

By the time the Austrian Currency Commission was convened in 1892, all the leading manufacturing, agricultural and financial interests had agreed behind the scenes on the necessity for currency reform to bring the appreciation of the Austrian florin to a halt. And they all concurred in the desirability for Austria-Hungary to establish a gold standard, while they initially argued over the particular rate of exchange at which the new currency – the crown – would be stabilized.

Mises' essay reads partly as what, today, would be considered a “public choice”-type analysis of the special interest politicking that often guides public policy. It brings out how a “concentrated benefit” to a wide array of interest groups served to generate a consensus on a significant institutional change in the existing monetary system. And how the “costs” or burdens imposed on a variety of smaller interest groups – particularly creditors and a number of medium-sized businesses who gained from currency appreciation, and conservatives who opposed a gold standard on ideological grounds – could be outweighed and outmaneuvered into being unable to prevent the monetary reform.

But at first, the Austro-Hungarian Bank was not legally compelled to redeem its notes for specie (gold). Its initial task was to prevent any further appreciation of the new crown from its formal foreign exchange rate. It was not given any direct instruction to prevent any renewed depreciation, if it were to occur. This, too, was consistent with the “dynamics” of the coalition of interest groups that had opposed any further increase in the value of the currency, but had not objected to the earlier years of currency depreciation.

But after 1896, the Austro-Hungarian Bank had accumulated enough gold and an amount of foreign exchange that it was able to assure the stability of the Austrian crown's foreign exchange rate within both the upper and lower ends of the "gold points," and in fact kept it within less than one percent away from the parity rate most of the time. And after 1900, the Bank was redeeming and issuing its notes for gold as well as for foreign exchange on an unofficial *de facto* basis, while still not legally required to follow a policy of specie redemption.

This was the context in which Mises wrote four of the essays in this volume: "The Problem of Legal Resumption of Specie Payments in Austria-Hungary," "The Foreign Exchange Policy of the Austro-Hungarian Bank," "About the Problem of Legal Resumption of Specie Payments in Austria-Hungary," and "The Fourth Privilege of the Austro-Hungarian Bank."

Mises' argument was that there was nothing keeping the Austro-Hungarian Bank from, now, being given the legal obligation to redeem gold on demand for its bank notes, and, thus, formally joining the international community of gold standard nations. He insisted that this would immediately raise the creditworthiness of debt issued by the Austrian and Hungarian governments on foreign markets, and therefore lower the costs of borrowing from international creditors. It would, also, improve global confidence in Austria-Hungary as a developing nation desirous of attracting foreign investment and lowering the cost of international capital for Austrian entrepreneurs.

Opponents of formal specie redemption argued that requiring the Austro-Hungarian Bank to redeem gold would risk a large hemorrhage of specie reserves at any time an international crisis induced holders of crown notes to transfer their liquid capital

out of the country. If during such an international crisis other central banks were to raise interest rates to protect their gold reserves from the danger of capital flight, the Austro-Hungarian Bank would be compelled to also raise its interest rate to prevent loss of its own gold reserves.

Domestic manufacturing and commerce would, then, find that the cost of capital was held captive to the uncontrollable market forces of international finance. Domestic interest rates could experience swings that would carry negative effects for business within the country, merely to counteract speculators who wished to move gold in and out of the country to take advantage of interest rate spreads that had nothing to do with the legitimate needs of the import and export trade to facilitate their international transactions. These critics argued it was far better to maintain the present system of *de facto* specie payments, which gave the Austro-Hungarian Bank the latitude and liberty to, at any time, refuse gold or foreign exchange redemption for its notes to shelter the domestic economy from unnecessary and destabilizing interest rate changes.

Mises counter-argued in these articles that since the 1860s, first the old Austrian National Bank and then its successor, the Austro-Hungarian Bank had legal authority to hold a sizable portion of its reserves against notes outstanding (even when official redemption was not imposed) in foreign bills of exchange, foreign currency and other foreign denominated assets that were, themselves, redeemable abroad in specie money. In other words, the Austrian central bank operated on the basis of a gold-exchange standard rather than a full gold standard. Through this method the Austro-Hungarian Bank was able to earn a significant interest income from its reserve holdings instead of its gold sitting “idle” in the Bank’s vaults. And these foreign earnings, at the same time, went not

only to the Bank's stockholders, but were shared by law with the Austrian and Hungarian governments, thus, reducing what otherwise might have been higher taxes to cover government expenditures.

For a long time the Bank already had been utilizing its holdings of foreign exchange and other foreign denominated assets precisely to substitute for having to meet every demand with an actual gold outflow. This not only was an effective tool for meeting "legitimate" needs for specie in international transactions, but to counteract speculative demands for gold or foreign exchange to keep the crown's foreign exchange rate within the gold points, beyond which it would become profitable to export or import gold.

Furthermore, the Austro-Hungarian Bank did, in fact, export gold at times of international crisis, as well as on a regular basis. In "normal" times it exported gold precisely to replenish its stock of foreign exchange, foreign bills of exchange, and other foreign denominated assets redeemable in specie abroad to maintain a supply sufficient to cover its international dealings and obligations. And during international financial crises it consciously exported gold to markets in Germany, Great Britain, and France to help alleviate the pressure for gold abroad, and at the same time earned a handsome return when gold prices were high. By supplying gold to foreign markets at such times, it also reduced the need to raise interest rates at home since the gold exports reduced the need for other central bank to raise their interest rates to protect their own gold reserves.

Finally, even while not legally obligated to redeem its notes for specie, the Austro-Hungarian Bank used its discount rate when it deemed it necessary to dampen the demand for both gold and other foreign denominated assets among its reserves on the part

of “speculators” and any others. Thus, the Bank was already doing all the very things that it would be required or could do under formal specie redemption to both maintain the official parity rate and preserve its gold reserves from undesired withdrawals. From any of the critics’ perspectives, no case could be reasonably made against the Austro-Hungarian governments legislatively enacting the final completion of the currency reform process that had begun in 1892.

So why did the Austrian and Hungarian governments never pass the legislation establishing formal specie redemption on the part of the Austro-Hungarian Bank? Mises gave no fully satisfactory answer in these articles, which were all published in respected scholarly journals of the time.

However, in his *Memoirs* Mises explained that behind the scenes the opposition to formal convertibility was partly due to the fact that a portion of the rather large funds earned from foreign exchange dealings by the Austro-Hungarian Bank were hidden away in a secret account from which senior political and ministerial officials could draw for various “off the books” purposes, including influencing public opinion through the media. He learned about this special fund from Eugen von Böhm-Bawerk (1851-1814),⁴⁴ the internationally renowned Austrian economist and Mises’ mentor, who told him about it off the record. Böhm-Bawerk was disgusted by the whole business and frustrated by the fact that even when he was finance minister (1900-1904), he had not been able to abolish the fund. A good part of the opposition and anger expressed against Mises’ defense of legal convertibility was the fear by those accessing these special funds that this

⁴⁴ For a short biography of Böhm-Bawerk and his contributions to Austrian Economics and service as Austro-Hungarian minister of finance, see, Richard M. Ebeling, “Eugen von Böhm-Bawerk: A Sesquicentennial Appreciation,” *Ideas on Liberty* (February 2001) pp. 36-41.

source of money would dry up under the more transparent accounting procedures that would come with legal redemption.⁴⁵

In his 1909 article on “The Problem of Legal Resumption of Specie Payments in Austria-Hungary,” Mises did point out that one reason behind the opposition to legal convertibility was the resistance of the Hungarians. They wanted to weaken the power of the joint Austro-Hungarian Bank as a way to continue their drive for independence from the Habsburg monarchy. Since the Compromises of 1867:

Hungarian politics have ceaselessly endeavored to loosen the common bonds that connect that country to Austria. The achievement of economic autonomy from Austria has appeared as an especially important goal of Hungarian policy, as a preliminary step leading to political independence. The national rebirth of the non-Magyar peoples of Hungary – Germans, Serbo-Croatians, Romanians, Ruthenians, and Slovaks – will, however, pull the rug out from under these endeavors and contribute to the strengthening of the national ideal of Greater Austria. At the moment, however, Hungarian policy is still determined by the views of the Hungarian nobility and the power of the government rests in the hands of the intransigent Independent Party.

The nationalistic “rebirth” of these peoples under the often oppressive control of the Hungarians did not strengthen the “national ideal of Greater Austria” – that “Austrian idea” of a harmonious multinational empire under the reign of the Habsburgs – that Mises assumed and clearly hoped would triumph. Instead, the appeal of nationalism over individual liberty and liberalism that had been developing throughout the Empire for decades finally contributed to the death of the Hapsburg dynasty in 1918.

⁴⁵ Mises, *Memoirs*, pp. 37-39.

But if the centrifugal forces of nationalism were pulling the Empire apart from within, it was also being undermined by the fiscal cost and growth of the State. This was the second theme in Mises' policy writings before the First World War, in two essays on "Fiscal Reform in Austria" and "Disturbances in the Economic Life of the Austro-Hungarian Empire during the Years 1912-1913."

After having its financial house in order for almost twenty years, Mises pointed out, the Austrian government was now threatening the fiscal stability of the society with increasing expenditures, rising taxes, and budget deficits. Government spending was likely to significantly grow in future years partly due to the expenses of maintaining costly military forces in an environment of an international arms race. The other major factor at work on the spending side of the government's ledger book were social welfare expenditures that the Austrian authorities were taking on, and which would only grow in the years ahead. Already in the preceding ten years, government spending had increased by over fifty-three percent, and over the same decade the cost of funding the government's debt had increased by nearly twenty percent.

The costs of financing many of the ministries was exploding; the nationalized railway system was running large deficits that had to be covered from other government funding sources; and the Austrian Crownlands were managed with a three-layered bureaucratic system of administrators at the national, provincial and municipal levels, each with their own rules, regulations, and taxing authorities – and often in contradiction with each other.

To cover these expenditures, a wide variety of taxes were being increased including inheritance taxes, sales and excise taxes, and income and corporate taxes. They

frequently were manipulated to shift the incidence of the tax burden away from the agricultural and rural areas of Austria on to the shoulders of the urban populations and especially on industry and manufacturing. In addition, the finance ministry wanted to implement legislation giving the government the authority to examine the books of businesses and industries. Mises observed that, “Austrian entrepreneurs rightly see in this arrangement an intensification of the harassment that the authorities display toward them.” While the tax rates and burdens that Mises analyzes and criticizes seem by today’s higher and more intrusive fiscal standards to be part of that bygone, idyllic world of limited government liberalism before the First World War, they all represented significant increases at the time, and all pointing in a dangerous direction for the future.

What Mises, also, found most disturbing in the coalition of political forces raising taxes and shifting them on to industry and the urban areas was a clear ideological bias against modern capitalist society. There were conservative and rural interests who wished for a return to the pre-industrial era, Mises claimed, and were using their preponderant representation in the Austrian parliament to place roadblocks in the way of modernization, and delay if not stop the economic development of the country.

The economic crisis in Austria-Hungary in 1912 and 1913, Mises argued, showed that fiscal irresponsibility was pervasive both in the government and the private sector. Everywhere consumption spending was growing at the expense of savings, while everyone did all in their power to avoid work.

Government expenditures were expanding and eating away at the hard won wealth and capital accumulation of previous years as a result of government deficit spending. But the private sector was no more frugal than government. In every walk of

Austrian life, people attempted to live beyond their means. Everyone lived on credit that depended upon the illusion that debts accumulating on the books of retailers and wholesalers eventually could be repaid. Retailers extended credit to their customers; wholesalers extended credit to retailers; and the financial institutions extended credit to the wholesalers, manufacturers and merchants.

It was a financial game of musical chairs in which everyone throughout the entire chain of production and sales appeared to be prosperous and profitable only because of the claims on the books against others up and down the payment structure of the economy. A serious default anywhere along the line could set off repercussions that would threaten the entire financial system. And precisely because of this, whenever anyone failed to pay even a fraction of the balances owed, the lines of credit were extended further to put off the inevitable day of reckoning and keep the illusions going.

The financial crisis of 1912-1913, Mises explained, had been partially that day of reckoning in which the financial system was found to be built on sand. Mises could only hope that some lessons would be learned that consumption needed to be based on production, and debts undertaken needed to be repaid through savings, work, and investment. He feared that the lessons had not been learned. Within a matter of months after writing in early 1914 his analysis of the causes and consequences of this crisis, Austria-Hungary was plunged in to a far more disastrous crisis from which it would not survive as a political entity.

In two pieces written in 1913, “The General Rise in Prices in the Light of Economic Theory” and “Rising Prices and Purchasing Power Policies,” Mises had attempted to explain the monetary mechanism by which increases in the supply of money

and credit bring about a general rise in prices. Mises develops part of the argument that he had formulated in 1912, in *The Theory of Money and Credit*,⁴⁶ that the period of inflation through which Austria-Hungary and much of the world was passing was due to the expansion of credit by the banking system in the form of fiduciary media. The latter, in Mises' terminology, are money substitutes in the form of bank notes and checking deposits that are claims against specie currency held as reserves by the central bank and other lending institutions. However, such fiduciary media may be of two sorts, those that Mises calls "commodity credit" that is fully backed by bank reserves and "circulation credit" that is only partially backed by reserves in the banking system. It is the fractional reserve basis behind a growing amount of the fiduciary media in circulation, Mises insists, that is the real cause of price inflation and the business cycle. Creating and lending unbacked fiduciary media at artificially lowered rates of interest produce an imbalance between savings and investment that leads to an unsustainable boom, which finally has to end in an economic downturn and a period of readjustment in the market.⁴⁷

But Mises suggested that there was another influence generating a general rise in prices, which he argued was caused by the nature of monetary transactions in an increasingly complex market order. In a developed market with multi-staged processes of production, in which producers no longer meet face-to-face with their ultimate consumers, each seller must "fix" his prices on the basis of his expectations about what

⁴⁶ Ludwig von Mises, *The Theory of Money and Credit*, pp. 261-366.

⁴⁷ For a detailed exposition of the Mises' "Austrian" theory of the business cycle, see, Richard M. Ebeling, *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition*, Ch. 7 on "The Austrian Economists and the Keynesian Revolution: the Great Depression and the Economics of the Short-Run," pp. 203-272; Ch. 8 on "Two Variations of the Austrian Monetary Theme: Ludwig von Mises and Joseph A. Schumpeter on the Business Cycle," pp. 273-301; and Ch. 9 on "Money, Economic Fluctuations, Expectations and Period Analysis: the Austrian and Swedish Economists in the Interwar Period," pp. 302-331. Also, Richard M. Ebeling, *Austrian Economics and the Political Economy of Freedom*, Ch. 5 on "Ludwig von Mises and the Gold Standard," pp. 136-158.

he thinks buyers further down the production chain may be willing to pay. This expectation about what his buyer will be willing to pay, in turn, influences the price he will be willing to pay to the producer or wholesaler from whom he purchases goods.

To the extent that such a seller expects that his buyer may be willing to pay more, he, then, will be willing to pay prices from those who sell to him that he otherwise might consider to be too high. Thus, Mises argued, a “dynamic” is set in motion that results in a continuing rise in prices throughout the various sectors of the economy in a certain temporal sequence. For example, trade unions may demand wages from employers that they might consider more than the workers’ labor to be worth. But if those employers are confident that they can pass on the cost of paying higher money wages to those to whom they sell their products, they acquiesce in money wage demands that would otherwise be unjustifiable. At the same time, the higher real wages that those workers hope to obtain through an increase in their money wages will be eroded as prices of finished goods continue to rise in the economy due to this general inflationary process throughout the market. What trade unions might consider their demonstrated capacity to improve the real wages of workers was illusory, since over time any temporary gains would be washed out by the general rise in prices. In the long run workers could not obtain real wages in excess of the value of their marginal product.

Mises went as far as to say that there really was nothing that could be done about this inherent price increasing process; he even suggested that it was indicative of a dynamic and growing economy in which constant shifts in supply and demand and the conditions and methods of production required pricing decisions to be made on the basis of expectations under inescapable uncertain future market conditions. Mises concluded

that the fact that the economy was not “static” and, therefore, not more fully predictable, was a reason for optimism that these changing economic circumstances were bring about improvements all the time.

What is missing in this part of Mises’ analysis is any clear link in his argument with either a prior or simultaneous increase in the supply of money and fiduciary media that permits this price inflationary process to continue, or that it would imply a increase in the velocity of money that would allow the same number of market transactions to be facilitated at rising prices. As he formulated it in these two articles, his argument seems to represent a version of what in the post-World War II period became known as “cost-push” inflation.⁴⁸

War Financing, Inflation and the Goals of International Trade Policy

When war broke out in the summer of 1914, Mises’ artillery reserve unit was called up for active duty. For part of the next four years he sometimes saw intense action on the eastern front against the Russian Army. However, in 1918, during the last year of the war, Mises was assigned to work in various consulting capacities for the Austrian High Command in Vienna. And for a short period of time he served in Austrian-occupied Ukraine involved with currency matters.⁴⁹

In 1916, he published an article on the “Goals of Trade Policy.” Mises presents a clear analysis of the gains from division of labor and international trade. But he goes on

⁴⁸ See, Fritz Machlup, “Another View of Cost-Push and Demand-Pull Inflation” [1960] in *Essays on Economic Semantics* (New Brunswick, NJ: Transaction Books [1963] 1991) pp. 241-268; also, Gottfried Haberler, *Inflation: Its Causes and Cures* (Washington, D.C.: American Enterprise Institute, 1966) pp. 65-78, and Gottfried Haberler, *Economic Growth and Stability* (Los Angeles: Nash Publishing, 1974) pp. 99-116.

⁴⁹ For a thorough discussion of Mises’ wartime activities, see, Jörg Guido Hülsmann, *Mises: The Last Knight of Liberalism*, pp. 257-298.

to explain that what motivated nations such as Germany and Austro-Hungary was a particular dilemma. As relatively over-populated countries in Europe, the greater economic opportunities in foreign countries resulted in emigration that meant a loss of manpower for future wars and part of the work force to man home front industry during peace as well as at times of international conflict. Also, in the cultural struggles between countries, emigration meant a loss of part of a nation's human heritage, since over time many such emigrants were absorbed into the culture and language of the host nation.

Thus, in countries like Germany and Austria-Hungary the task was to develop policies that would raise the living standards and opportunities in the homeland to reduce the incentive to leave and be "lost" to the fatherland. Rejecting free trade, the nationalist trade method became protectionist barriers to artificially raise prices and secure domestic employments for the population. Or such a country could attempt territorial expansion into surrounding areas to gain the land and resources that would overcome the too-densely populated condition within the pattern of existing political boundaries in which, for example, Germany was currently confined. One other method was to acquire colonies abroad to which emigrants could move while retaining their cultural identity and political allegiance to the fatherland.

Written at a time of war, Mises carefully emphasized that these political trade policy goals were in the long run incompatible with the economic forces of an increasingly global market society. These forces were constantly working to guide both labor and capital to where their productive capacity was most highly valued, which inevitably would result in redistributions of people around the world to reflect their most

optimal employments in the international division of labor. In the long run, the logic and incentives of the market would transcend the political goals of nationalist ideology.

In a memorandum on, “Remarks Concerning the Problem of Emigration,” that Mises prepared for the Austrian government commission to which he was assigned in Vienna in 1918, he suggested a variety of domestic policies that would reduce the incentive for workers to leave Austria. These included making more farmland available out of existing larger estates for the benefit of small landholders who currently could not support their families on the properties they owned. It would be useful for the government and private associations to assist seasonal migrant labor in finding more attractive wage and work condition opportunities abroad that would assure a greater likelihood they would return home to a country that cared about their well being. It was also necessary to reduce the burden and inconveniences of compulsory military service that too often induced some workers employed abroad to not come home.

Also in the summer of 1918, Mises delivered a public lecture “On Paying for the Costs of War and War Loans.” He praised the military successes of Austria’s armed forces in its fight against the Allied Powers and the industrial efficiencies of Austrian business that had provided the manufacturing wherewithal for Austria to do so well, even in the face of Allied blockades that cut Austria off from foreign sources of supply. But production had to be paid for; and the issue arose of whether the government’s war costs should be covered by taxation or debt.

Mises reminded his listeners that borrowing did not enable the current generation to shift any part of the costs of war to a future generation. Current consumption could only come out of current production, and this applied no less to consumption of finished

goods designed for and used in war. Whether the war was financed by taxes or borrowing, the citizenry paid for it today by foregoing all that could have been produced and used, if not for the war. And Mises also explained to his audience what today is often referred to as the “Ricardian Equivalence Theorem,” named after British economist David Ricardo (1772-1823). In his 1820 essay on the “Funding System,” Ricardo argued that all that the borrowing option entailed was a decision whether to be taxed more in the present or more in the future, since all that was borrowed now would have to be paid back at a later date through future taxes; therefore in terms of their financial burden the two funding methods can be shown to be equivalent, under specified conditions. Ricardo, however, also pointed out that due to people’s perceptions and evaluations of costs in the present versus the future, they were rarely equivalent in their minds.⁵⁰

But Mises raised a different point in favor of certain benefits to debt financing for the government’s war expenditures. First, many who would not have the liquid assets to pay lump-sum wartime taxes would either have to sell off less liquid properties to pay their tax obligation, or would have to borrow the required sum to pay the tax. In the first case, a sizeable number of citizens might have to liquidate properties more or less all at the same time to improve their cash positions, which would put exceptional downward pressure on the market prices of those assets. This would impose a financial loss on those forced to sell these properties and assets to the benefit of those who were able to buy them at prices that would not have been so abnormally low if not for the war and need for ready cash to pay the tax obligation. Secondly, to the extent that some citizens would need to borrow to cover their wartime tax payments, the private individual’s

⁵⁰ David Ricardo, “Funding System” [1820] in Piero Sraffa, ed., *The Works and Correspondence of David Ricardo*, Vol. IV: *Pamphlets and Papers, 1813-1823* (Cambridge: Cambridge University Press, 1951), pp. 149-200, especially, pp. 186-187.

creditworthiness undoubtedly would be much lower than that of the government's. As a consequence, the rates of interest these private individuals would have to pay would be noticeably higher than the rate at which the government could finance its borrowing. Thus, the interest burden from government borrowing that would have to be paid for out of future taxes would be less for the citizenry than the financial cost from them having to borrow the money in the present to cover all the costs of war through current taxation.⁵¹ Hence, it was both patriotic and cost-efficient for those listening to Mises' presentation to buy war bonds in support of the war effort.

Finally, in another lecture delivered on "Inflation" in the late summer of 1918, Mises explained the impact from the government financing a large amount of its war expenditures through monetary expansion. First, all creditors who had failed to anticipate the resulting depreciation in the value of the Austrian crown are paid back in money possessing less purchasing power than when the loan was issued. This might seem to be a desirable side effect, since clearly the debtor gains by paying back his loan in depreciated crowns, especially if it is "the poor" who are the predominant debtor group. But it was worth recalling, Mises said, that in modern society the debtors were most often businesses that had borrowed to cover investment costs, while the creditors were middle class citizens, widows and orphans, civil servants, and members of the lower-income "working class" who had put their savings in the financial institutions that did the lending. Hence, Mises pointed out, in this debtor-creditor relationship, under inflation the "rich" benefitted at the expense of the middle class and the "poor."

⁵¹ See, also, *Ludwig von Mises, Nation, State, and Economy: Contributions to the Politics and History of Our Time* (Indianapolis, IN: Liberty Fund [1919] 2006) pp. 136-142.

Some saw the benefit from inflation in that it also reduced the real value of the government's accumulating debt, thus reducing the "real" cost of the war. And at the same time, rising money incomes and profits in the private sector due to inflation meant that the government gained higher tax revenues in money terms. On the other hand, to the extent to which the government had covered part of its debt with foreign borrowing denominated in another currency, the falling value of the crown on the foreign exchange market due to inflation increased the amount of crowns the government had to pay to meet its foreign financial obligations. Also, some taxes were fixed at a specified level, so in this instance the taxpayer gained in real terms during inflation while the government lost. And furthermore, the worse and more continuing the inflation, the more reluctant citizens would be to buy war bonds and other government debt instruments, thus increasing the difficulties of financing the war other than through inflation. Thus, from a variety of perspectives inflation was a dangerous and undesirable method of covering the costs of war, since it undermines the real wealth of the middle class and those in the working class who saved in the attempt to improve their position in society.

After War: Hyperinflation and Fiscal Mismanagement in the New Austria⁵²

In October and November of 1918, the Austro-Hungarian Empire began to disintegrate as various national groups began to break away and declare their independence, most notably the Czechs and Slovaks who joined in creating their own country, then the Hungarians, who were then followed by the Serbs, Croats, Slovenians, and Bosnians who formed a new Yugoslavia. The Romanians soon began to incorporate

⁵² See, Richard M. Ebeling, *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition*, Ch. 5, "The Economist as the Historian of Decline: Ludwig von Mises and the Austria Between the Two World War," especially pp. 92-100 for a detailed account of the political and economic situation in Austria in the years following the end of the First World War.

Transylvania within their borders, and Italy seized the south Tyrol and the port of Trieste. Galicia became a battleground between the Poles, Ukrainians, and the Russian Bolsheviks in the next few years.

In what was declared the new state of German-Austria a coalition government was formed between the Social Democrats, the Christian Socialists, and the Nationalist Party. Almost immediately, they began a campaign of expensive food subsidies for the urban population at controlled prices, compulsory requisitioning of agricultural goods from the rural parts of the country, foreign exchange controls on all imports and exports at an artificial rate of exchange, an vast array of social welfare programs, and the use of the monetary printing press to finance it all. By the middle of 1919 and then into 1920 and 1921, serious inflation had degenerated into hyperinflation.⁵³

Mises' articles on "Monetary Devaluation and the National Debt" and "For the Reintroduction of Normal Stock Market Practices in Foreign Exchange Dealings," explained that the foreign exchange rate was a market-created price that could not be simply fixed and manipulated by the state. The value of any one currency in terms of another was ultimately a reflection of each currencies purchasing power. Guided by the "law of one price," the market tendency was to establish the exchange rate at that point at which the attractiveness of buying some quantity of a good in either country was the same. Setting the exchange rate at some level other than the market-determined rate merely meant that it was artificially fixed at too dear or too cheap a price. In the face of

⁵³ For a brief history of the inflation in Austria during and after the First World War, and its disastrous consequences, see. Richard M. Ebeling, "The Great Austrian Inflation," *The Freeman: Ideas on Liberty* (April 2006) pp. 2-3; also Richard M. Ebeling, "The Lasting Legacies of World War I: Big Government, Paper Money and Inflation" *Economic Education Bulletin*, Vol. XLVIII, No. 11 (Great Barrington, MA: American Institute for Economic Research, November, 2008), for accounts of the hyperinflations in both Germany and Austria.

the currency shortages that the exchange control resulted in, the government, then, commanded that all foreign exchange earnings be sold to the Austrian Exchange Control Authority at the fixed rate, with the government bureaucracy now determining the rationing of it to either importers and exporters.

Prohibiting normal foreign exchange dealings merely drove transactions underground into the black market, and prevented the functioning of those institutional arrangements through which individuals can hedge against uncertain fluctuations in the foreign exchange rate by utilizing a legal futures market. Instead, the inflationary environment, with limited legal avenues to “take cover” against the effects of a depreciating currency, meant that more and more people were shifting into the use of foreign monies in domestic Austrian business transactions. The foreign exchange controls needed to be abolished, and the printing presses needed to be brought to a halt if a monetary disaster was to be averted.

The fundamental cause for Austria’s problems was that it was in the stranglehold of the socialist idea, with all of its negative consequences. This was the theme in Mises’ two pieces on “The Austrian Problem” and “The Social Democratic Agrarian Program.” The socialists were determined to control and spend their way into the destruction of the country. Taxes and inflation ate away at the accumulated wealth of the past and hindered any capital formation in the present. They demagogically promised wealth while causing waste by nationalizing and regulating industries that ended up suffering losses that needed to be paid for through even more inflation. Their agricultural agenda was to do with the rural economy the same harm they were doing with industry and manufacturing in the cities.

What was to be done? In February 1921, Mises presented the outline of a plan in answer to the question, “How Can Austria Be Saved?” The first order of business was to stop the monetary printing presses. But this successfully could be done only if the costly food subsidies were eliminated and the nationalized industries were re-privatized to end the huge expenses to cover their deficits, so the national budget once again could be brought into balance. Foreign exchange controls had to be abolished with a free market in all currency dealings. At the same time the value of the Austrian crown had to be stabilized once the central bank had stopped issuing paper money and the depreciation of the currency was brought to a halt. All domestic regulations and controls inhibiting free commerce among the various provinces of Austria had to be lifted, and free trade had to be reintroduced in all forms of foreign trade. This was the path to a revitalized and prosperous Austria.

A sound monetary system was unlikely if the governments of those new states that had formerly been part of the Austro-Hungarian Empire looted the assets of a reconstructed Austrian central bank. Thus, in his piece on, “The Claims of Note Holders Upon Liquidation of the Bank,” also published in February 1922, Mises argued against those who asserted that those other governments had a right to a portion of the old Austro-Hungarian Bank’s gold reserves. Under the Treaty of St. Germain, which had ended the war between Austria and the Allied powers, the successor states were obligated to redeem the old crown notes on their territories for their own respective currencies. The old Austro-Hungarian Bank notes were then to be turned over to the new Austrian central bank, which would take them out of circulation. Mises argued that everyone knew that the huge expansion of bank notes to fund the government’s war expenses were backed by

nothing, and certainly not by whatever gold may have remained in the central bank's vaults. To demand anything else would be to plunder the gold and other assets upon which a reconstituted Austrian monetary system would be built.

Mises observed in an article early in 1922 on "The Austrian Currency Problem Thirty Years Ago and Today" that the key to ending Austria's problems was stopping the inflation. Thirty years earlier, in 1892, the task had been to stabilize a currency that was appreciating in value. The task in 1922 was to bring a halt to its depreciation. But the method was the same: link the currency to gold and do not manipulate its quantity in circulation.

As the situation worsened, Mises put together a proposal on behalf of the Vienna Chamber of Commerce for "The Restoration of Austria's Economic Situation," which was submitted to other trade and labor union associations in the country to devise a way to bring an end to the government budget deficits as a prelude to stopping the inflation. In a nutshell, Mises recommended the establishment of price indexation throughout the economy. Already government expenditure levels were automatically adjusted in line with a cost of living index. Now the same had to be set up for government revenues. Otherwise, nominal expenditures would keep growing while nominal tax revenues would always lag behind, never leading to an end to the deficits. Incomes, profits, and wages and prices all had to be indexed to the market value of gold. This would continually adjust government tax revenues to government expenditures. It would mean that government nationalized sectors, such as the railway system, would have their prices rise in tandem with the average rate of depreciation of the currency reflected in its link to the price of gold, which would help to reduce their losses and maybe even earn a profit from

transit fees for cargos passing through Austria. At the same time, gold indexation would assist in keeping the wages and salaries of many workers rising to maintain a certain real value of their income.

Mises emphasized that such an indexation policy was not only desirous due to questions of equity in a period of rapid depreciation and the need to bring the government's budget better into balance. It was also the fact that inflation distorted the very essence of a money-using economy: the ability for economic calculation to reasonably estimate profit and loss, and relative profitability of alternative lines of production. Price and wage indexation linked to the price of gold, would help to reduce the miscalculations that inflation caused, and which often resulted in capital consumption. This measure, Mises stated, was meant to be a transition method to bring stability to the Austrian economy, or as he concluded, "We must make up our minds to return from the extravagant intoxication of spending 'billions' to the sober, more modest financial figures of a smaller State. The object of the proposed plan is to avoid a sudden and disastrous collapse."

The inflation *was* brought to a halt in late 1922 and early 1923 with the financial assistance and supervisorial oversight of the League of Nations. In 1925, in an article dealing with "The Gold-Exchange Standard," Mises pointed out that while Austria and a number of other countries were moving back to a gold-backed currency, it was not a full gold standard system. Most countries did not have large amounts of actual gold reserves, and gold coins were nowhere in circulation. Instead, their monetary systems (like under the old Austro-Hungarian Bank) were gold-exchange standards, under which most reserves were held in other countries in the forms of financial assets that were, in

principle, redeemable in gold in those other countries. The entire system depended upon at least a few countries, like the United States at that time, being willing to serve as an ultimate gold reserve redeemer. It was clear that Mises thought that this was only a shadow of the type of real gold-backed system that could assure non-inflationary stability to the various countries of the world.

In 1926, Mises had spent three months traveling in the United States. When he returned he delivered a talk on, “America and the Reconstruction of the European Economy.” Any further European recovery from the effects of the Great War could not count upon American political or economic leadership. Both manufacturing and agricultural interests in the United States were heavily protectionist and therefore resistant to imports that, in turn, made it difficult for Europeans to find markets for their goods or to earn the dollars to pay back their wartime loans to America. While the United States was a creditor nation with the means to invest in Europe, money would not be given away but would depend on the profitability of such investments. Thus, Europe would have to rely upon itself if it was to continue to overcome the legacy of the war.

Mises pointed out the difficulty for such stable recovery and growth in a summary he presented in 1928 on, “The Currency and Finances of the Federal State of Austria.” Five years after the end to Austria’s inflation, the currency was on a relatively sound basis, with a new schilling having replaced the old crown and with the new schilling fixed at a specific value in terms of gold. The rules under which the new Austrian National Bank operated made it difficult for it to serve as a means to finance the expenses of the government.

However, the fiscal affairs of the nation were far from sound. The government was still running budget deficits, but all of it was due to cost overruns in the nationalized sectors of the economy, especially the railway system and the lumber industry in the nationalized forest system. Financial pressures were placed on the federal authority because of the tax and related transfers to the provincial governments, which were all overlaid with bureaucratic regulatory structures and mismanagement. And in Vienna, where the Social Democrats controlled the municipal government, the financial extravagance on public projects was exceptionally large. For domestic growth and international competitiveness, Austria had to make its economy more productive. Cutting wasteful government and radically reducing taxes was the only avenue to a prosperous future for Austria.

When the Great Depression began in the early 1930s, the banking system was badly shaken. The collapse in May 1931 of the Austrian bank, CreditAnstalt, in particular, sent out shockwaves throughout the financial markets. Shortly afterwards, Mises wrote a piece on “The Economic Crisis and Lessons for Banking Policy.” In his eyes, the banking systems in Germany and Austria had two weaknesses. First, too many banks had become financially entangled with the industrial corporations to whom they lent. In fact, they often had become major shareholders in the very companies whose financial status they were supposed to oversee with a critical eye in terms of continuing creditworthiness. Instead, they unsoundly extended more credit to companies they should have pulled back from because their own balance sheets was too closely linked to the illusion of their continuing profitability. Finally, the situation imploded taking the banks down with those companies.

Second, those same banks had poorly managed the term structure of their investment portfolios. They lent long, while being liable for depositor withdrawals on demand. In other words, they had become caught in the system of fractional reserve banking, in which the amount of claims payable on demand far exceeded their available cash reserves to meet depositor liabilities.

The banking crisis, as far as Mises was concerned, was not the end of capitalism, but showed the need to reorganize the way banks managed their liabilities and investments after the crisis had passed. Sounder banking principles in a market economy were the avenue to avoid similar crises in the future.

Interventionism, Collectivism, and Their Ideological Roots

In the 1920s, one of the contributions for which Mises was most famous was his theory of government intervention. In 1930, he published a brief summary of his critique of “The Economic System of Interventionism,” with particular emphasis on the deleterious effects from all forms of price controls. While various forms of production regulations had the tendency to reduce productivity, the far more directly harmful type of intervention was control over prices. They inevitably distorted the relationship between supply and demand, artificially generated either shortages or surpluses, and deflected production from those avenues most likely to satisfy consumer demand. They also had a tendency to spread out to more and more sectors of the economy, as the government imposed similar controls on other markets and industries in a vain attempt to compensate for the imbalances the earlier price controls had created. If followed to their logical

conclusion, such price controls led to a fully planned economy through piecemeal interventions imposed one after another.

Where did all this lead? In a piece on “Economic Order and the Political System” in 1936, Mises pointed out that in the eighteenth and early nineteenth centuries political democracy, civil liberty, and economic freedom had grown hand-in-hand. But in the second half of the nineteenth century the idea had taken hold that political democracy and personal freedom could be preserved even if the government increasingly intervened and controlled the economic affairs of the citizenry in the name of social justice and socialist planning.

What the twentieth century was showing, however, is that political democracy and individual freedom could not long last when government planning increasingly replaces the market economy. Economic planning means planning people’s lives, and people must then conform in all their affairs to what the plan dictates. In countries like Soviet Russia, fascist Italy, or National Socialist (Nazi) Germany even the appearance of preserving democratic and personal liberties had been discarded and the reality of where planning leads could be most clearly seen. This was the crossroads that now confronted the remaining relatively free and democratic societies in the West: freedom or planning.

More than twenty years later, in 1959, Mises offered some “Remarks Concerning the Ideological Roots of the Monetary Catastrophe of 1923,” when the hyperinflation had brought Germany to the edge of total economic collapse. He reflected back to when he was a young man before the First World War, during the years when he wrote those early pieces on the gold standard and had only just published *The Theory of Money and Credit*. He had attended the meetings of the *Verein für Sozialpolitik* (Society for Social Policy),

the leading and most influential social science association in the German-speaking world, and which was dominated by members of the German Historical School. Here he came face-to-face with the enemies of economic liberalism, who rejected most of economic theory in the name of an historically-based approach to social analysis, and on the basis of which they rationalized aggressive nationalistic conclusions all leading to an eventual war. They had contempt for the Austrian Economists and ridiculed the idea that there were “laws of economics” that should stand in the way of markets and money being controlled by the state. These were the thinkers who were the harbingers of many of the disasters of the twentieth century. Their aggressive nationalism had lead to two World Wars; their belief in the interventionist state had cultivated the coming of the planned and regulated society; and their confidence that money and its value were creatures of the state had fostered the inflations of the twentieth century.

And though Mises did not point it out, many of these German thinkers laid the ideological groundwork for the mass murder of millions at the hands of the National Socialists, including the destruction of six million Jews. Indeed, it was because of such ideas and their consequences that Mises, himself, was forced to flee a Nazi-dominated Europe and find sanctuary in America in the midst of the Second World War.

Leaving Europe for America had not been an easy decision for Mises. Indeed, he said in a letter to Friedrich A. Hayek in May 1940, as he was approaching his departure from Switzerland for the United States, “The decision to leave is truly difficult. For me, it represents saying good-bye to a life which I have always lived, it is for me an ‘adieu’ to a Europe which is about to disappear forever.”⁵⁴

⁵⁴ Letter from Mises to Hayek, dated May 22, 1940, Geneva, Switzerland, in the Hayek Papers in the Hoover Institution archives; the original letter is in German.

It is only appropriate, therefore, that before concluding this introduction that we should take a look at Mises' Jewish family roots in the old Habsburg Empire and how the fate of the Austrian Jews lead to a man like Mises having to say good-bye to the life and world in which he made his career and won his reputation as one of the leading economists of his time; and his having to make a new start at the age of 58 in the New World.

Liberating Liberalism and the Austrian Jews⁵⁵

Ludwig von Mises was born on September 29, 1881 into a prominent Jewish family in Lemberg (Lvov in present-day Ukraine), the capital of the Austrian Crownland of Galicia, far to east of Vienna near the border with the Russian Empire. In the last decades of the nineteenth century, more than 50 percent of the population of some parts of Galicia was Jewish, with the center of Jewish life and culture being in the capital of Lemberg.⁵⁶

The documents that Ludwig von Mises' great-grandfather, Mayer Rachmiel Mises (1801-1891), prepared as background for his ennoblement by the Austrian Emperor Francis Joseph in mid-1881 (just a few months before Ludwig was born), records the history of the Mises family in Lemberg going back to the 1700's. Mayer's father, Fischel Mises, had been a wholesaler and real estate owner who had received permission to live and conduct business in the so-called "restricted district" reserved for non-Jews. At the

⁵⁵ Part of this section draws upon Richard M. Ebeling, *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition*, Ch. 3: "Ludwig von Mises and the Vienna of His Time," pp. 36-56.

⁵⁶ See, William O McCagg, Jr., *A History of Habsburg Jews, 1670-1918* (Bloomington, IN: Indiana University Press, 1989) pp. 105-122 & 181-200.

age of eighteen, Mayer married a daughter of Hirsch Halberstamm, the leading Russian-German export trader in the Galician city of Brody.

Mayer took over the family business following his father's death and also served for twenty-five years as a commissioner in the commercial court of Lemberg. For a period of time he also was on the city council and as a full member of the Lemberg Chamber of Commerce. He also was a co-founder of the Lemberg Savings Bank, and later was a member of the board of the Lemberg branch of the Austrian National Bank. He also was one of the founders of the Cracow-Lemberg railway line. In addition, he was a founder of a Jewish orphanage, a reform school, a secondary education school, a charitable institution for infant orphans, and a library in the Jewish community. Some of these charities were begun with funds provided by Mayer for their endowment. Indeed, it was for his service to the Emperor as a leader of the Jewish community in Lemberg that Mayer Mises, great-grandfather of Ludwig von Mises, was ennobled.

Mayer's oldest son, Abraham Oscar Mises, ran the Vienna office of the family business until he was appointed in 1860 the director of the Lemberg branch of the CreditAnstalt bank. Abraham also was the director of the Galician Carl-Ludwig Railroad. His other son, Hirsch Mises, was a partner in and a director of Halberstamm and Nirenstein banking company.⁵⁷

It is perhaps because of the family's connection with the railroad business that Hirsch Mises' son, Arthur Edler von Mises, took up civil engineering with a degree from

57 See Ch. 31 in the present volume for a translation of Mayer Rachmiel Mises' short curriculum vitae that he submit in June 1881 to the office of the Austrian Emperor, Francis Joseph, as part of the legal process for ennoblement and the bestowing of the honorific and hereditary title of "Edler von." He was ennobled on April 30, 1881, with the ennoblement document issued on July 13, 1881. Ludwig von Mises is not mentioned at the end of the document among Mayer Rachmiel Mises' great-grandchildren because Ludwig's birth was still three months off in September.

the Zurich Polytechnic in Switzerland, and then worked for the Lemberg-Czernowitz Railroad Company. Arthur married Adele Landau, the granddaughter of Moses Kallir and the grandniece of Mayer Kallir, a prominent Jewish merchant family in the city of Brody. Arthur and Adele had three sons, of whom Ludwig was the oldest. His brother, Richard, became an internationally renowned mathematician who later taught at Harvard University. The third child died at an early age.

Members of the Mises family also were devout practitioners of their Jewish faith. The vast majority of the Galician Jews were Hasidic, with all the religious customs and rituals that entailed. But the Mises family was part of that movement in the Jewish community devoted to theological and cultural reform, and participated in the liberal-oriented political activities that were attempted in nineteenth century Galicia. As a small boy, Ludwig would have heard and spoken Yiddish, Polish, and German, and studied Hebrew in preparation for his bar mitzvah.

Ludwig's father, Arthur, like many of his generation, chose to leave Galicia and make his life and career in the secular and German cultural world of Vienna, where he accepted a civil servant's position with the Austrian Ministry of Railways. But from the documents among Ludwig von Mises' "lost papers" found in the Moscow archives,⁵⁸ it is clear that his mother maintained ties to her birthplace, contributing money to several charities in Brody, including a Jewish orphanage. In Vienna in the 1890's, Arthur was an active member of the Israelite Community's Board, a focal point for Jewish cultural and political life in the Austrian capital.⁵⁹

⁵⁸ See, Richard M. Ebeling, "Mission to Moscow: The Mystery of the 'Lost Papers' of Ludwig von Mises," *Notes from FEE* (July 2004) pp. 1-3; also, for a more detailed account, see, Richard M. Ebeling, ed., *Selected Writings of Ludwig von Mises*, Vol. 2: "Introduction" pp. xv-xx.

⁵⁹ Robert S. Wistrich, *The Jews of Vienna in the Age of Franz Joseph*, p. 165.

Until the early and middle decades of the nineteenth century, Jews throughout many parts of Europe were denied civil liberties, often being severely restricted in their economic freedom, and especially in Eastern Europe, confined to certain geographical areas. In the 1820's it was still not permitted for Jews to unrestrictedly live and work in Vienna; this required the special permission of the Emperor.⁶⁰ Commercial and civil liberation of the Austrian Jews only occurred in the aftermath of the Revolution of 1848, and most especially with the new constitution of 1867, which created the Austro-Hungarian Dual Monarchy following Austria's defeat in its 1866 war with Prussia. The spirit and content of the 1867 constitution, which remained the fundamental law of the Empire until the collapse of Austria-Hungary in 1918, reflected the classical liberal ideas of the time. Every subject of the Emperor was secure in his life and private property; freedom of speech and the press was guaranteed; freedom of occupation and enterprise was permitted; all religious faiths were respected and allowed to be practiced; freedom of movement and residence within the Empire was a guaranteed right; and all national groups were declared to have equal status before the law.

No group within the Austro-Hungarian Empire took as much advantage of the new liberal environment as the Jews. In the early decades of the nineteenth century a transformation had begun among the Jewish community in Galicia. Reformers arose arguing for a revision in the practices and customs of Orthodox Jewry. Jews needed to enter the modern world and to secularize in terms of dress, manner, attitudes and culture. The faith had to be stripped of its medieval characteristics and ritualism. Jews should

⁶⁰ On the history of the Jews in the Austro-Hungarian Empire, see Wistrich, *The Jews of Vienna in the Age of Franz Joseph*; McCagg, *A History of Habsburg Jews, 1670-1918*; Steven Beller, *Vienna and the Jews, 1867-1938: A Cultural History* (Cambridge, MA: Cambridge University Press, 1989).; George E. Berkley, *Vienna and Its Jews: The Tragedy of Success, 1880s-1980s* (Lanham, MD: Madison Books, 1988); and Max Grunwald, *History of the Jews in Vienna* (Philadelphia: Jewish Publication Society of America, 1936).

immerse themselves in the German language and German culture. All things “German” were distinguished as representing freedom and progress.⁶¹

With the freedoms of the 1867 constitution, Austrian and especially Galician Jews began a cultural as well as a geographical migration. In 1869, Jews made up about 6 percent of the population of Vienna. By the 1890’s, when the young Ludwig von Mises moved to Vienna from Lemberg with his family, Jews made up 12 percent of the Vienna population. In District I, the center of the city around where the Mises family lived, Jews made up over 20 percent of the population. In the neighboring District II, the percentage was over 30 percent.⁶²

But in the late nineteenth and early twentieth centuries, there was a stark contrast between these two districts of the city. In the central district I, the vast majority of the Jewish population had attempted to assimilate with their non-Jewish neighbors in dress, manners, and cultural outlook. In District II, bordering on the Danube, on the other hand, the Jewish residents were more likely to have retained their Hasidic practices and orthodox manners, including their traditional dress. It was the visible difference of these Jews, who often had more recently arrived from Galicia, which so revolted the young Adolf Hitler – who was shocked, and wondered how people acting and appearing as they

⁶¹ This transformation of the Jewish communities in Central and Eastern Europe, especially in the German-speaking lands, is usually associated with the influence of Moses Mendelssohn beginning in the middle of the eighteenth century. See, Marvin Lowenthal, *The Jews of Germany: A Story of 16 Centuries* (Philadelphia, PA: The Jewish Publication Society of America, 1938), pp. 197-216; Ruth Gay, *The Jews of Germany: A Historical Portrait* (New Haven, CT: Yale University Press, 1992) pp. 98-117; Nachum T. Gidal, *Jews in Germany: From Roman Times to the Weimar Republic* (Köln, Germany: Konemann Verlagsgesellschaft mbH, 1998) pp. 118-123; Amos Elon, *The Pity of It All: A History of the Jews in Germany, 1743-1933* (New York: Metropolitan Books, 2002) pp. 1-64

⁶² On the demographics of the Jewish community in Vienna, see, Marsha L. Rozenblit, *The Jews of Vienna, 1867-1914: Assimilation and Identity* (Albany, NY: State University of New York Press, 1983).

did could ever be considered “real Germans.” They seemed such an obviously alien element in Hitler’s eyes.⁶³

The characteristic mark of most of the Jews who migrated to Vienna (and other large cities of the Empire such as Budapest or Prague) was their desire and drive for assimilation; in many ways they tried to be more German than the German-Austrians.⁶⁴ The Czechs, the Hungarians, and the Slavs, on the other hand, often were still focused on their traditional ways; the Hungarians in particular were suspicious of the Enlightenment, civil liberties, and equality – these threatened their dominance over the subject peoples in their portions of the Empire (the Slovaks, Romanians, and Croats). To constrain the Hungarians, the Emperor increasingly put the Czechs, Poles, and Slavs under direct Imperial administration on an equal legal footing with the German-Austrians. For the Jews, Austrian Imperial policy meant the end of official prejudice and legal restrictions, and a securing of civil rights and educational opportunities.⁶⁵ Their continuing and generally steadfast loyalty to the Habsburgs, however, led many of the other nationalities

⁶³ Adolf Hitler, *Mein Kampf* [1925] (Boston: Houghton Mifflin, 1943) p. 56: “Once as I was walking through the Inner City [of Vienna before the First World War] I suddenly encountered an apparition in a black caftan and black hair locks. Is this a Jew? was my first thought. For, to be sure, they had not looked like that in Linz. I observed the man furtively and cautiously, but the longer I stared at this foreign face, scrutinizing feature after feature, the more the first question assumed a new form: Is this a German?”

⁶⁴ On the parallel process of Jewish assimilation and resistance from non-Jews in Prague and Bohemia, see the autobiographical recollections of this period in, Hans Kohn, *Living in a World Revolution: My Encounters with History* (New York: Trident Press, 1964) pp. 1-46.

⁶⁵ Habsburg enlightenment was more advanced in many ways over that of the German government. For example, before the First World War it was virtually impossible for a Jew to be commissioned as an officer in the German Army, no matter what his qualifications and merit. On the other hand, Jews were accepted as officers in the Austrian Army with no similar prejudice, and is what enabled Ludwig von Mises to be commissioned as a reserve officer in the Austrian Army as a young man, and serve with distinction in the First World War on the Russian front. See, Wistrich, *The Jews of Vienna in the Age of Franz Joseph*, p. 174-175: “In striking contrast to the Prussian regiments, there was no deliberate exclusion of Jewish officers and anti-Semitism was not officially tolerated. Indeed, anti-Semitism appears to have been notably weaker in the army than in many other sectors of Austrian society in spite of persistent nationalist agitation and the fact that most officers were Roman Catholic Germans . . . In this supranational institution *par excellence* which was loyal to the Emperor and the dynasty alone, Jews were by and large treated on equal terms with other ethnic and religious groups. The army could simply not tolerate open racial or religious discrimination which would only undermine morale and patriotic motivation.”

to be suspicious and anti-Semitic as the years went by. The Jews were viewed as apologists and blind supporters of the Habsburg emperor, without whose indulgence and protection the Jews might have been kept within the ghetto walls.⁶⁶

Civil liberties and practically unrestrained commercial and professional opportunity soon saw the Jews rise to prominence in a wide array of areas of Viennese life.⁶⁷ By the beginning of the twentieth century more than 50 percent of the lawyers and medical doctors in Vienna were Jewish. The leading liberal and socialist newspapers in the capital were either owned or edited by those of Jewish descent, including the *New Free Press*, the Viennese newspaper for which Mises often wrote in the 1920's and 1930's. The membership of the journalists' association in Vienna was more than 50 percent Jewish. At the University of Vienna, in 1910, professors of Jewish descent constituted 37 percent of the law faculty, 51 percent of the medical faculty and 21 percent of the philosophy faculty. At the time Mises attended the University in the first decade of the 20th century almost 21 percent of the student body was Jewish. The proportion of Jews in literature, theatre, music and the arts was equally pronounced.⁶⁸

The main avenue for social and professional advancement was education in the Gymnasium system – the high school system in the German-speaking world. But the Gymnasium education not only offered the path to higher education and a university degree for many Jews, it also was an avenue for acculturation and assimilation into

⁶⁶ On the perception of the Jews before the First World War by the various nationalities of the Austro-Hungarian Empire, including the Austrian-Germans, see, Henry W. Steed, *The Hapsburg Monarchy*, pp. 145-194.

⁶⁷ See, Jerry Z. Muller, *The Mind and the Market: Capitalism in Modern European Thought* (New York: Alfred A. Knopf, 2002) p. 350-352.

⁶⁸ On the occupational demographics, see, Rozenblit, *The Jews of Vienna, 1867-1914*, pp. 47-70; Beller, *Vienna and the Jews, 1867-1938*, pp. 165-187.

European and especially German culture. For example, Mises and his fellow student Hans Kelsen (who later became an internationally renowned philosopher of law and the author of the 1920 constitution of the Republic of Austria) attended the *Akademisches Gymnasium* in the center of Vienna. It was meant for students preparing for the university and professional careers. Here a wide liberal arts education was acquired with mandatory courses in Latin, Greek, German language and literature, history, geography, mathematics, physics, and religion, with electives in either French or English – Mises selected French. At the core of the curriculum also was the study of the ancient Greek and Roman classics. Mises and other Jewish students at the *Akademisches Gymnasium*, as a part of their religion training, had courses in Hebrew.⁶⁹

According to memoirs written by people who attended the *Akademisches Gymnasium* in the 1880's and 1890's, most of the students ridiculed the religion classes as “superstition.” The Greek and Roman classics were considered as literary avenues for entering the mainstream of modern European and Western culture. And while it was not assigned, the students absorbed on their own contemporary writings in history, social criticism, literature, and the sciences as their way to integrate themselves into modern and “progressive” society.⁷⁰

In the 1890's, during Mises' time at the *Akademisches Gymnasium*, 44 percent of the student body was Jewish. But there were some Gymnasiums at which Jewish admission was informally restricted. For example, the Maria Theresa Academy of

⁶⁹ On the Vienna gymnasiums, and Jewish assimilation and social and economic advancement, see Rozenblit, *The Jews of Vienna, 1867-1914*, pp. 99-126; Beller, *Vienna and the Jews, 1867-1938*, pp. 49-70.

⁷⁰ See, Arthur Schnitzler, *My Youth in Vienna* (New York: Holt, Rinehart and Winston, 1970), for a rich memoir on the *Akademisches Gymnasium* in Vienna a few years before Mises attended as a student. Also, see, the fascinating account of Viennese gymnasium life during this time in, Stefan Zweig, *The World of Yesterday*, pp. 28-66.

Knights in Vienna was reserved for the children of the nobility and senior officials. Joseph Schumpeter attended it in the 1890's, but only because his stepfather was a Lt. Field-Marshal. No matter what his academic qualification, Mises would have had virtually no chance to be accepted there. The result was that there were clusters of these Gymnasiums that were clearly closed to Jews, even if they were converts to Christianity, while other clusters represented the high schools where middle-class Jewish businessmen, professionals and civil servants sent their children.⁷¹

But for all their assimilationist strivings – their conscious attempts to be German-Austrians in thought, philosophy, outlook, and manner – the Jews remained distinct and separate. Not only was this because they belonged to schools, professions, and occupations in which they as Jews were concentrated, but because non-Jewish German-Austrians viewed them as separate and distinct. However eloquent and perfect their German in literature and the spoken word, no matter how contributing they were to the improvement of Viennese society and culture, most non-Jewish Viennese considered these to be Jewish contributions to and influences on German-Austrian corners of cultural life.⁷²

Name, family history, gossip, and mannerisms made it clear to most people who were Jewish and who were not. The wide and pronounced success of so many Viennese

⁷¹ On the Maria Theresa Academy of Knights in Vienna during the time when Schumpeter attended, see, Robert Loring Allen, *Opening Doors: The Life and Work of Joseph Schumpeter*, Vol. 1 (Brunswick, NJ: Transaction Books, 1991) pp. 18-22; and, Richard Swedberg, *Schumpeter: A Biography* (Princeton, NJ: Princeton University Press, 1991) pp.10-12.

⁷² In 1897, a prominent Jewish liberal political figure pointed out in a Vienna newspaper the German-Austrian attitude to the attempt by many Jews to fully integrate themselves into Austrian life: "When you consider the way the poor Jews strive to gain your favor in the ranks of the Germans, how they try to accumulate the treasures of German culture, how they work in the sciences, some perhaps dying young as a result – and still all the thanks they get is that they are not even accepted as human beings." Quoted in Steven Beller, *Vienna and the Jews, 1867- 1838*, p. 163.

Jews made non-Jews conscious of their preponderance and presence in many visible works of life. And it served as the breeding ground for anti-Semitism.⁷³

In the Habsburg domain part of this anti-Semitism was fed by conservative and reactionary forces in society who often resented the Emperor's diminishment or abolition of the privileges, favors, and status of the Catholic Church and the traditional landed aristocracy. The high proportion of Austrian Jews involved in liberal or socialist politics made them targets of the conservatives who said they were carriers of modernity, with its presumption of civil equality, unrestrained market competition, and a secularization that was said to be anti-Christian and therefore immoral and decadent. Preservation and restoration of traditional and Christian society, it was claimed, required opposition to and elimination of the Jewish influence on society. Jews were the rootless "peddlers" who undermined traditional occupations and ways of earning a living, as well as the established social order of things. They pursued profit. Honor, custom, and faith were willingly traded away by them for a few pieces of gold, it was said. Craft associations became leading voices of anti-Semitism, especially when economic hard times required small craftsmen and businessmen to go hat in hand to Jewish bankers for the borrowed sums to tide them over these times of economic trouble.⁷⁴

⁷³ On the nature and evolution of anti-Semitism in Germany and Austria, see, Peter G. J. Pulzer, *The Rise of Political Anti-Semitism in Germany and Austria* (New York: John Wiley, 1964); and Bruce F. Pauley, *From Prejudice to Persecution: A History of Austrian Anti-Semitism* (Chapel Hill: University of North Carolina Press, 1992).

⁷⁴ That the real target behind much of the anti-Semitism in Germany and Austria was economic liberalism has been suggested by Frederick Hertz, *Nationality in History and Politics*, p. 403: "It was rightly felt by many that the real object of [anti-Semitic attacks such as those by the Germany historian Heinrich von Treitschke] was not the Jews, but liberalism, and that the Jews were only used as a means for working up public opinion against its fundamental principles." And by Hans Kohn, *Prophets and Peoples: Studies in Nineteenth Century Nationalism* (New York: Macmillan, 1946), pp. 124-125: "Treitschke's words, 'The Jews are our misfortune,' served as a rallying banner for the German anti-Semitic movements for the next sixty years. Though the Jews were the immediate goal of the agitation, it ultimately aimed at the liberalism that had brought about Jewish emancipation. Treitschke hated the liberal middle-class society of the West and despised its concern for trade, prosperity and peace . . . In view of the apparent decay of the Western

German nationalism also was a vehicle for growing anti-Jewish sentiment. The paradox here is that in the 1860's and 1870's a sizeable number of Jewish intellectuals were founders and leaders in the Austrian and German nationalist movements. German culture and society were viewed as representing the universal values of reason, science, justice and openness in both thought and deed. German culture and political predominance within the Austro-Hungarian Empire held back the backward-looking forces of darkness, i.e., the Hungarian, Czech, and Slavic threats. At the same time, German culture in Central Europe offered rays of enlightenment in the regions of Eastern Europe.

Mises estimated that before the Second World War, Jews made up 50 percent of the business community in Central Europe and 90 percent of the business community in Eastern Europe.⁷⁵ Indeed, in *Omnipotent Government* he asserted that in Eastern Europe “modern civilization was predominantly an achievement of Jews.”⁷⁶ What the Jews in these parts of Europe introduced and represented, at least in their own minds, was the enlightened German mind, with its culture and institutions. But to those other

world through liberalism and individualism, only the German mind with its deeper insight and its higher morality could regenerate the world.” See, also, F. A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press [1944] 2005) p. 161: “In Germany and Austria the Jew had come to be regarded as the representative of capitalism because a traditional dislike of large classes of the population for commercial pursuits had left these more readily accessible to a group that was practically excluded from the more highly esteemed occupations. It is the old story of the alien race being admitted only to the less respected trades, and then being hated still more for practicing them. The fact that German anti-Semitism and anti-capitalism spring from the same root is of great importance for the understanding of what has happened there, but this is rarely grasped by foreign observers.” And, Fritz Stern, *The Politics of Cultural Despair: A Study in the Rise of Germanic Ideology* (Berkeley, CA: University of California Press, 1961) pp. 142-143: “Of course, the Jews favored liberalism, secularism, and capitalism. Where else but in the cities, in the free professions, in an open society, could they escape from the restrictions and prejudices that lingered on from the closed, feudal society of an earlier era? They were, and in a sense had to be, the promoters and profiteers of modernity, and for this . . . [many Germans] could not forgive the Jews.”

⁷⁵ Ludwig von Mises, “Postwar Economic Reconstruction of Europe” [1940] in Richard M. Ebeling, ed., *Selected Writings of Ludwig von Mises*, Vol. 3: *The Political Economic of International Reform and Reconstruction*, p. 27.

⁷⁶ Ludwig von Mises, *Omnipotent Government: The Rise of the Total State and Total War* (New Haven, CT: Yale University Press, 1944), p. 185.

nationalities being introduced to and “threatened” by this German cultural influence, it was perceived as Jewish as much as being German – a dominating, imperial, and “foreign” culture.

At the same time, in both Germany and German-Austria, the Jews in the forefront of the Pan-German nationalist movements were viewed as interlopers by many of the Christian German nationalists. As a consequence, there emerged in the second half of the nineteenth century rationalizations to justify the rejection of Jewish participation in the cause of German nationalism and culture. First, it was said that only Christians and the Christian faith were consistent with true German life and culture. But when a significant number of German and Austrian Jews converted to Christianity, it still was found not to be enough. Now it was claimed that to be a true German it was not sufficient to be a convert to Christianity. “Germanness” was a culture, an attitude towards life and a certain sense of belonging to the Volk community.

As a growing number of Jews immersed themselves into all things German – language, philosophy, literature, dress and manner – it was found, again, not to be enough. Really to be a German was to share a common ancestry, a heritage of a common blood lineage.⁷⁷ This was one barrier the German and Austrian Jews could not overcome. In the emergence of racial anti-Semitism in the 1880’s and 1890’s, there were laid the seeds of the “final solution.”

⁷⁷ This attitude was expressed, as one example, during the 1930s by the ardent National Socialist Adolf Bertels, who said about Heinrich Heine, possibly, after Goethe, the greatest German writer of the nineteenth century, that “however well he handles the German language and German poetical forms, however much he knows the German way of life, it is impossible for a Jew to be a German.” Quoted in Alistair Hamilton, *The Appeal of Fascism: A Study of Intellectuals and Fascism, 1919-1945* (London: Anthony Blond, 1971) p. 109.

In Vienna, Karl Lueger, who was mayor of the capital city in the first decade of the twentieth century and a leader of the Christian Social Party, represented the spirit of anti-Semitism. He insisted that only “fat Jews” could weather the storm of capitalist competition. Anti-Semitism, Lueger said, “is not an explosion of brutality, but the cry of oppressed Christian people for help from church and state.”⁷⁸ He blended anti-Semitism with social-left reforms, which included civil service and municipal government restrictions on Jewish access to city jobs or contracts. On the other hand, when Lueger was challenged as to why he had Jewish friends and political associates, he replied, “I decide who is a Jew.”⁷⁹

But in spite of the presence and growth of anti-Semitic attitudes in the late nineteenth and early twentieth centuries in Austria in general and Vienna in particular, Mises’ seeming lack of attention to his own Jewish family background or any hint of the impact of anti-Semitism around him – there were anti-Jewish student riots at the University of Vienna during the years when he was a student there around the turn of the century – was in fact not uncommon.⁸⁰ One can read Stefan Zweig’s fascinating account of everyday life in the Vienna of this time, and have the distinct impression that anti-Semitic attitudes or municipal government policy were virtually non-existent.

⁷⁸ Quoted in, J. Sydney Jones, *Hitler in Vienna, 1907-1913: Clues to the Future* (New York: Cooper Square Press, 2002) p. 155.

⁷⁹ Ibid., p. 157; also, Berkley, *Vienna and Its Jews*, pp. 103-111; on the history of the Christian Social movement with its blending of anti-Semitism, anti-capitalism, and socialism, and Lueger’s role and participation in it, see, John W. Boyer, *Political Radicalism in Late Imperial Vienna: Origins of the Christian Social Movement, 1848-1897* (Chicago: University of Chicago Press, 1981), and John W. Boyer, *Culture and Political Crisis in Vienna: Christian Socialism in Power, 1897-1918* (Chicago: University of Chicago Press, 1995).

⁸⁰ Mises barely mentions anti-Semitic sentiments in Austria in his *Memoirs*, and only devotes time to a detailed discussion of it in *Omnipotent Government*, pp. 169-192, written during the Second World War. For a discussion of Mises’ critique of anti-Semitism, see Richard M. Ebeling, *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition*, Ch. 3, “Ludwig von Mises and the Vienna of His Time,” especially, pp. 43-49.

Yet the circles in which people moved in Viennese society both before and after the First World War existed with many invisible walls. Traditional or Orthodox Jews lived and worked within a world of their own in the city.⁸¹ Secular and assimilated Jews, like Ludwig von Mises and Hans Kelsen, moved in circles of both Jews and non-Jews; but even the non-religious and German-accultured Jews clustered together. A review of the list of participants in Mises' famous private seminar in Vienna, for example, shows a high proportion of Jews.⁸² And even after Mises had moved to Geneva, Switzerland in 1934, his agenda books for this time show that many of his social engagements were with other Jews residing in or visiting that country.

The end of the nineteenth and the beginning of the twentieth century saw the eclipse of liberalism in Austria and the rise of socialism in its place, centered in the political ascendancy of the Social Democratic Party. A sizable number of Jews were prominent in the Austrian Socialist movement; they were anti-capitalist and viewed the entrepreneurial segment of the society as exploiters and economic oppressors. The capitalist class would to be swept away in the transformation to socialism, including the Jewish capitalists in the "ruling class." Most of the Jews in the socialist movement were not only secular and considered themselves as harbingers of the worker's world to come; they were contemptuously opposed to cultural and religious Judaism as well.⁸³

These three political movements in Austria and Vienna when Mises was a young man – conservatism, German nationalism, and radical socialism – were, each for its own reasons, enemies of liberal society, opponents of free-market capitalism, and therefore

⁸¹ Harriet Pass Freidenreich, *Jewish Politics in Vienna, 1918-1938* (Bloomington, IN: Indiana University Press, 1991) pp. 138.

⁸² Mises, *Memoirs*, p. 83

⁸³ See, Robert S. Wistrich, *Socialism and the Jews* (East Brunswick, NJ: Associated University Presses, 1982).

threats to the ideas and occupations of those middle class, or “bourgeois,” walks of life heavily populated by the Jews of Austria and Vienna.

The history of Austrian Jewry during this time is a story of triumph and tragedy. The winds of nineteenth century liberalism freed the Austrian Jewish community, both internally and externally. Internally, the liberal idea pried open Orthodox Jewish society in places such as Austrian Galicia. It heralded reason over ritual; greater individualism over religious collectivism; open-minded modernity over the strictures of traditionalism. Externally, it freed the Jewish community from legal and political restraints and restrictions. The right of freedom of trade, occupation, and profession opened wide many opportunities for social improvement, economic betterment, and political acceptance.⁸⁴

Within two generations this transformed Austrian Jewish society. And within that same span of time it saw the rise of many Jews to social and economic prominence, with greater political tolerance than ever known before. If these two liberating forces had not been at work, there would not have been Ludwig von Mises – the economist, the political and social philosopher, and the notable public figure and policy analyst in the Austria both before and between the two World Wars.

At the same time these two liberating forces set the stage for the tragedy of the German and Austrian Jews. Their very successes in the arts and the sciences, in academia, and in commerce fostered the animosity and resentment of those less

⁸⁴ Many of the Jews in Germany and Austria understood that connection between economic liberalism and individual opportunity that had enabled so many in the Jewish community to prosper in spite of anti-Semitic sentiments. Thus, for example, in 1897, Emil Lehmann, head of the Dresden Jewish community argued against the Social Democrats, “In the Mosaic teaching the ideals of justice and equality before the law find their substantiation just as envy and hatred – which the Social Democracy share with the anti-Semites – receives the sharpest condemnation. Thou shalt not covet! Other demands contrary to civilization such as the abolition of the family, State education of children, etc. etc, which are desired by the Social Democrats, are firmly rejected in the Ten Commandments.” Quoted in Wistrich, *Socialism and the Jews*, p. 69.

successful in the arenas of intellectual, cultural, and commercial competition. It set loose the emotion of envy, the terror of failure, and the psychological search for scapegoats and excuses. It ended at the gates to the Nazi death camps.

In Mises' case and for many others it meant leaving the country of their birth and seeking refuge in other lands. Among those who left before or immediately after Germany's annexation of Austria were many members of the Austrian School of Economics or Mises' private seminar circle (both Jews and non-Jews): Martha Steffy Browne, Gottfried Haberler, Friedrich A. Hayek, Felix Kaufmann, Fritz Machlup, Ilse Mintz, Oscar Morgenstern, Paul N. Rosenstein-Rodan, Alfred Schutz, Erich Voegelin, to name just a few.

Mises had departed in the autumn of 1934 for a teaching position at the Graduate Institute of International Studies in Geneva, when it was clear that the collectivist darkness was starting to fall over the center of Europe. He made a new life for himself after 1940 in the United States, like many of his Austrian colleagues and friends, where the spirit of freedom was not yet in the same shadow of tyranny as in their native Austria. America, for them, was still a land where Austrian Jews such as Mises could still breathe the air of liberty.

He continued to explain and defend the principles and ideals of classical liberalism and the free market in his new home in America until his death on October 10, 1973, at the age of 92.

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