

The Austro-German Relationship

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The cornerstone of Germany's coalition in the First World War was the Dual Alliance between itself and Austria-Hungary. While the prewar political relationship between these two countries has been well studied, their economic relationship has not. This is unfortunate because there is a definite correlation between the degree of trade and investment between the two countries and their degree of political cooperation. When German capital flows to Austria-Hungary increased and the Austro-Hungarian economy was booming, the Austro-Hungarian leaders were strongly supportive of the Kaiser's foreign policy. On the other hand, when the Austro-Hungarian economy was depressed, the country's leadership hesitated in its support for Germany. The politico-economic relationship between Germany and Austria-Hungary can only be fully understood by tracing the transformation of the Austrian Hapsburg empire from Germany's chief rival for power in Central Europe into Germany's primary ally and economic satellite.

The struggle between Hohenzollern Prussia and Hapsburg Austria for control over Germany and supremacy in Central Europe dates back to the early eighteenth century and the reigns of Frederick the Great and Maria Theresa. Prussia was a militaristic state on the rise and Austria was a multinational empire decaying due to nationalist and liberal forces. Weakened by the revolutions in 1848, it was simply a matter of time before the Austrian influence would be completely driven out of Germany. The fateful moment arrived on 3 July, 1866, when Prussia's armies crushed the Austrian forces at Königgrätz in Bohemia. Austria was then forced to accept the status of a second-class power in Central Europe. The Prussian dominance of Central Europe was further established by the Franco-Prussian War which left the new German Empire supreme and unrivalled.

Forced to accept German supremacy in Central Europe as *fait accompli*, Austria found itself practically encircled by potentially hostile states. The growing Italian state in the west claimed Austria's western province of Tyrol and the city of Trieste, and Russia was proclaiming itself the protector of the Slavs with an interest in Slavic nationalist movements throughout the Balkans. The Russian point would later be driven home in the Russo-Turkish War of 1877-1878 which arose out of Russia's intervention on behalf of the Serbs, Montenegrins and Bulgarians against Turkey. This war drew the states

of Serbia and Montenegro toward the Russian sphere of influence and increased Russian interests in the Balkans as a means of eventually gaining control of the Turkish straits.

The idea of encirclement was, understandably, politically unacceptable to the Austrian leaders. They needed an ally against Russian expansionism and could not risk another war on their own against either Germany or Italy. Since Italy and Russia had claims to Austrian territories inhabited by Italians and Slavs, respectively, Germany seemed the logical choice. The choice was made easier by Bismarck's insistence that Germany was a satisfied state with no further territorial claims.¹

The first attempt at an alliance between Austria and Germany also included the Russians in the Three Emperor's League of 1873. In 1873, France was not yet a threat to Germany because it was still recovering from its defeat in the Franco-Prussian War and Russia seemed satisfied with the balance of power in Europe.² The League, therefore, was more of a return to the conservative monarchist ideals embodied a half-century earlier in the Holy Alliance. The fragility of such an alliance based on ambiguous ideals rather than solid political objectives was revealed when the alliance dissolved in 1875 over a crisis in the Balkans.

As the crisis erupted into the Russo-Turkish War in 1877, war between Austria-Hungary and Russia seemed a real possibility. When the two countries each sought German support in the crisis, Bismarck offered to arbitrate the matter at a European congress. In the subsequent congress, the Congress of Berlin, Germany sided with Austria-Hungary against Russia and deprived the Russians of many of their gains in the war. Fearing the Russian reaction to the outcome of the Congress, Austria-Hungary negotiated with Germany for protection against a possible Russian attack. The subsequent negotiations resulted in the Dual Alliance of 1879 in which both nations promised to help defend the other from a Russian attack or, if attacked by a third party, they promised at least benevolent neutrality.³

Bismarck's political rationale for making such a treaty with Austria-Hungary to the exclusion of Russia, was embodied in his memo to the Kaiser on 24 August, 1879:

With Austria we have more in common than with Russia. German kinship, historical memories, the German language, the interests of the Hungarians. For us — all that makes an alliance with Austria more popular, perhaps also more enduring in Germany than an alliance with Russia. Only dynastic

¹ DONALD KAGAN, *Western Heritage since 1648*, Vol. II (NY: Macmillan, 1987), 873; see also DIETRICH ORLOW, *A History of Modern Germany* (Englewood Cliffs, NJ: Prentice-Hall Inc., 1991 - first edition, 1987), 56-57.

² KAGAN, 873.

³ For Germany, France was the third party, for Austria, Italy was the most probable third party.

links, in particular the personal friendship of the Tsar Alexander, were more favorable in Russia... Once this advantage of the Russian alliance, if it did not disappear, at least became uncertain, I deemed it imperative that the policy of Your Majesty should cultivate our relations with Austria even more intensely than before.⁴

Bismarck also believed that Russia was more satisfied with the status quo in Europe and less likely to come to an accommodation with France than Austria-Hungary would be.⁵ For this reason Austria-Hungary had to be tied to Germany through a binding political alliance and increased economic ties.

As early as 1867, Bismarck had been allowing massive amounts of German capital to flow into Austria. Of the \$1,000 million from the French indemnity to Germany, nearly a fourth (about a billion German marks) ended up in Austrian domains.⁶ While much of this was invested in Austrian and Hungarian government and railroad securities, a significant portion went into setting up joint-stock ventures in the Austro-Hungarian Empire. In the period between 1867 and 1873, over a thousand joint-stock companies had been set up with German assistance.⁷ The German banking community, with its big D-banks, became closely allied to many of these Austrian ventures. The D armstadter Bank was particularly active in Austria-Hungary. The D armstadter replaced the Paris Rothschilds and the Credit Mobilier of France as the major partner of the Vienna Rothschilds in many important industrial and railroad ventures.⁸

This close economic relationship was part of the foundation for the Dual Alliance because it made the alliance "popular" in both countries as indicated in Bismarck's memo to the Kaiser. In fact, the closer relationship between Germany and Austria-Hungary after 1879 led to a series of on-going discussions about the creation of a Central European customs union centred around Germany and Austria-Hungary.⁹ These hopes were eventually realized once Count Leo von Caprivi replaced Bismarck as chancellor.

Caprivi, like Bismarck, believed that Germany was a continental power and its most important area of concentration was Central Europe. To conso-

⁴ IMANUEL GEISS, *German Foreign Policy, 1871-1914* (London: Routledge and Kegan Paul, 1976), 36.

⁵ "Memorandum by Bismarck, Kissingen", (June 15, 1877); as quoted in GEISS, 183.

⁶ MAX WIRTH, *Geschichte der Handelskrisen* (Frankfurt, 1883); as quoted in *Documents of European Economic History*, ed. by S. POLLARD and C. HOLMES, Vol. 2 (NY: St. Martin's Press, 1972), 250. Of the five billion French francs from the French indemnity, Wirth estimates a billion markes worth was invested in Austria.

⁷ WIRTH, 252.

⁸ HERBERT FEIS, *Europe the World's Banker, 1870-1914* (NY: Augustus Kelley, 1964), 65.

⁹ GUSTAV GRATZ, *The Economic Policy of Austria-Hungary during the War* (New Haven: Yale Univ. Press, 1928), 4.

lidate German influence in this area, Caprivi wanted to institute a trade policy which emphasized lower tariffs for key trading partners with an aim to expanding the German manufacturers' export markets.¹⁰ This policy culminated in 1891 with the "Caprivi Treaties", which created a customs union between Germany, Austria-Hungary, Italy, Switzerland, and Belgium.¹¹

The treaty provided a major boost to the Austro-Hungarian economy. While Austria-Hungary was developing a sizable industrial sector, it remained primarily an exporter of raw materials and agricultural products.¹² Throughout the 1890s, Austria-Hungary remained one of Germany's most important sources of grain, second only to Russia.¹³ This is significant since Caprivi's trade policies were hurting German agricultural interests. The agricultural interests were part of the nucleus of Bismarck's conservative coalition of "Iron and Rye" in the Reichstag. Caprivi alienated his own German agrarians to help the Austrian agricultural interests. To alienate this powerful lobby, Caprivi must have placed a heavy emphasis on the need to help Austrian agricultural interests (which were the most influential voices in the Austrian government).

The trade treaties also opened opportunities for the development of the Austro-Hungarian petroleum industry. Petroleum in the 1890s was rapidly becoming one of the most important and lucrative industries for industrialized states. The increased use of diesel engines in industry and shipping (especially naval vessels¹⁴), and for illumination and lubrication made it a much sought-after commodity. Since Germany lacked indigenous sources of petroleum, its industrialists and navalists hoped to develop sources which it could secure for its exclusive use. As early as 1888, Austria-Hungary had become

¹⁰ GEISS, 61-65. Caprivi's vision of Germany's role in Central Europe as stated by Capt. Muller (later Admiral and Chief of the Navy cabinet) in a private memorandum to Prince Heinrich, the Kaiser's brother: "General von Caprivi believed that Germany had no chance at all of becoming a world power, and consequently his policy was designed only to maintain (Germany's) position on the European continent. He was therefore acting quite logically in working at home for the strengthening of the army, limiting the navy to the role of defending the coastline... and seeking good relations with England as the natural ally against Russia, the country which threatened Germany's position in Europe".

¹¹ FRITZ FISCHER, *War of Illusions*, trans. Marian Jackson (NY: Norton & Co., 1974), 296.

¹² *U.S. Consular Reports*, No. 143 (August, 1892), 608-9.

¹³ *U.S. Consular Reports*, No. 152 (May, 1893), 103, and *U.S. Consular Reports*, No. 192-195 (September-December, 1896), 324.

¹⁴ GEOFFREY JONES and C. TREBILCOCK, "Russian Industry and British Business 1910-1930: Oil and Armaments" *Journal of European Economic History*, No. 1, Vol. 11 (Spring 1982), 65. In 1913, the British Admiralty purchased controlling interest in the Anglo-Persian Oil Co. after announcing that it planned all of its future vessels to be oil fuelled.

the world's third largest producer of the commodity¹⁵ and Germany was its sole export market. The Germans hoped that the reserves of the fields in Austria's Galician provinces might someday rival those of Pennsylvania or Russia's Causcasian fields.¹⁶

To exploit these fields, German entrepreneurs moved aggressively into the area. The Deutsche Bank invested nearly \$1,900,000 in order to finance companies like Deutsche Petrol A.G. to drill in Galicia and the Bavarian Lloyd Company to transport the oil back to Germany.¹⁷ Austria-Hungary not only benefited from the increased development and revenue that these industries created, but from associated projects the Germans planned in order to fully exploit the fields. Among these was a canal project in the 1890s that would link the Danube river to the Oder.¹⁸

The increased economic ties during the 1890s between Germany and Austria-Hungary indicated to the French the strength of the alliance. The animosity the French had for the Germans was now extended to the Austro-Hungarians. This meant the flow of capital from Paris was slowly cut-off. Austrian and Hungarian securities were no longer admitted to the Paris bourse, railroad stocks were sold off, and French banks and industrial firms refused to enter into contracts and ventures with Austro-Hungarian enterprises.¹⁹ If France had not been so heavily involved in the Austro-Hungarian economy, this would not have been a major problem for the Austrians — but this was not the case.

Austro-Hungarian securities had for quite some time been a favourite item on the Paris bourse. French investors in 1890 possessed roughly 50% of the Austrian and Hungarian government bonds and State Railway bonds that were in foreign hands. This compares with German investors holding 40% and British investors holding just under 10%.²⁰ Austria's main railway companies, the Southern (Lombard) Railroad and the State Railway, were built with French capital and had most of their shares listed on the Paris bourse.²¹

In the short term, the lack of access to French money markets had few significant effects. Germany stepped into the shoes of the French and helped to finance the Austro-Hungarian debt. By 1903, Germany accounted for 50% of the foreign-owned Austrian and Hungarian government securities, France

¹⁵ *U.S. Consular Reports*, No. 289 (October, 1904), 177.

¹⁶ "The German Octopus", *Near East*, no. 118, Vol. V (August 8, 1913), 403.

¹⁷ "The German Octopus", *Near East*, No. 118, Vol. V (August 8, 1913), 403.

¹⁸ *U.S. Consular Reports*, No. 143 (August, 1892), 582.

¹⁹ FEIS, 211.

²⁰ FEIS, 201-202. Actual numbers were given in pounds sterling, £35 million for France, £27.6 million for Germany, and £6.8 million for Britain. EDUARD MÄRZ, *Austrian Banking and Financial Policy*, trans. Charles Kesler (NY: St. Martin's Press, 1981), 31. Nearly half of all Austro-Hungarian securities were foreign owned in 1901.

²¹ FEIS, 201.

held 35% and Britain held less than 4%.²² From 1905 to 1913, Germans held more Hungarian government securities than the Austrians.²³ Germany also stepped up other long-term investments so that a fourth of all German foreign investments in Europe, or roughly \$700 million, were in Austria-Hungary by 1914.²⁴

Despite Germany's liquidity problems, this financing proved to be adequate for several years. Austria-Hungary did not need much external capital to stimulate its economy during this period. The 1890s saw Austria-Hungary involved in no major military conflicts and having no need for major military build-ups. The Austrian Empire also entered this period with an adequately developed railway system and a slowly developing industrial sector. These factors kept government spending to an absolute minimum and allowed heavy investment from foreign and domestic sources to occur in the private sector.

So much investment occurred in these years that the Austro-Hungarian economy entered a period of near sustained economic boom. In 1902, 539 joint-stock companies absorbed \$430 million and received net profits of approximately \$30 million — an average return of 7.1%.²⁵ By 1912, 707 joint-stock companies were holding \$822 million and were receiving net profits of \$94 million — an average return of 11.4%.²⁶ The largest companies leading the boom were oil companies, utilities, and chemical firms.²⁷

The capital financing this economic growth was mostly indigenous capital. While the German D-banks did participate in many ventures centered around raw-material extraction and transportation, it was the indigenous Austro-Hungarian banks which fuelled the growth. Banks such as the Creditanstalt in Vienna mobilized domestic capital as a joint-stock investment company, not unlike the Credit Mobilier in France. They then operated like the German D-banks by working closely with a few large industries. A good example of this is the way the Creditanstalt was the primary financier of the Skodawerke — Austria's largest armaments concern.²⁸

As Austria-Hungary's economic growth and industrialization became more rapid, its capital needs increased. Germany tried to keep pace with the

²² S. POLLARD, *European Economic Integration, 1815-1970* (London: Thames & Hudson, 1974), 78.

²³ JOHN KOMLOS, "Economic Growth and Industrialization in Hungary, 1830-1913", *Journal of European Economic History*, Vol. 10, No. 1 (Spring 1981), 26.

²⁴ FEIS, 74. The Germans had three billion marks invested in Austria-Hungary.

²⁵ MÄRZ, 8. Actual figures have been converted to US\$. Listed figures were 2,075,000,000 crowns as invested capital, and 148,000,000 crowns as net profits.

²⁶ MÄRZ, 8. Listed figures were 4,050,000,000 crowns as invested capital, and 461,000,000 crowns as net profits.

²⁷ MÄRZ, 9.

²⁸ MÄRZ, 9-10.

growing demand for capital by stepping up its flow of capital. By 1912, a quarter of all loans Germany sent abroad were going to Austria-Hungary.²⁹ Germany's low tariff policy toward Austria-Hungary continued to assist Austro-Hungarian exports by making them relatively cheap. Germany remained Austria-Hungary's most important market to the point where 39% of all of Austria-Hungary's exports went to Germany — its next largest export market was Britain which received only 9.1%.³⁰

The expansion of trade and capital flows from Germany did not provide adequate capital to assist Austria-Hungary's continued economic growth. Part of the reason for this was that the Austro-Hungarian government had increased government spending since 1901. Beginning with another major railroad construction programme which absorbed over \$200 million, the Austro-Hungarian government expanded government expenditure.³¹ The First Moroccan Crisis of 1905-1906 and the Bosnian Crisis of 1908 increased the possibility of a general war throughout Europe. This provoked major armaments expenditures in all of the Great Powers of Europe; Austria-Hungary was no exception. Military expenditures made the empire's state budget increase from about \$370 million in 1905 to about \$590 million in 1910.³² As the budget increased, the government's ability to deal with the expenditure decreased. The state debt began to rise dramatically. While yearly deficits averaged about \$22 million throughout the 1890s, they had averaged a little more than \$30 million in the first decade of the twentieth century and mushroomed to about \$110 million a year by 1912.³³

The rapid industrialization of Austria-Hungary also increased the need for machinery and manufactured goods to build new factories and expand the infrastructure. This turned Austria-Hungary's long string of trade surpluses into large trade deficits. In 1908, after the Bosnian Crisis, Austria-Hungary registered its first trade deficit in over thirty years. While it was a modest \$15,700,000 in 1908, by 1912, the trade deficit had ballooned to \$150,900,000.³⁴ The trade deficit was a clear indication that Austria-Hungary was experiencing demand inflation for the first time in its history.³⁵

²⁹ FISCHER, 296.

³⁰ FISCHER, 296.

³¹ MÄRZ, 6-7. Actual programme outlays amounted to a billion crowns over four years. While the programme aided economic growth during the early XXth century, it also increased government deficits.

³² MÄRZ, 27. Expenditures were given in Austrian crowns - 1,830,000,000 for 1905, and 2,901,000,000 for 1910.

³³ MÄRZ, 28. Figures of 109,000,000 crowns were given for the 1890s; 149,000,000 crowns in the 1900s; and 541,000,000 crowns for 1912.

³⁴ RICHARD RUDOLPH, *Banking and Industrialization in Austria-Hungary* (Cambridge Univ. Press, 1976), 230. In Austrian crowns, the trade deficit was 77,600,000 in 1908, and 743,200,000 in 1912.

³⁵ MÄRZ, 30.

The inflation also led to major problems for the Austro-Hungarian banking community. As capital flows became tighter, interest rates mounted and liquidity problems became more frequent. While the discount rate of Vienna's money markets hovered around four percent in 1909, it was pushing over six percent at the outset of the Balkan Wars in November 1912, when Austria-Hungary mobilized its army.³⁶ The inflationary pressures also seemed to have led to arbitrage activities in foreign money markets with the Austrian crown. This prompted a drain of the state's gold reserves. This is indicated by the Austro-Hungarian Bank's (the state's central bank) attempt to strengthen its gold reserves by floating a loan in New York in late 1912.³⁷

On a corporate level, the heavy military expenditures stimulated some companies' portfolios but financial stringency continued to hamper their operations. An example of this is the *Stabilimento Tecnico Triestino* shipyards. *Stabilimento's* operations were boosted by contracts for three dreadnoughts after 1909 from the Austro-Hungarian Navy and several orders for smaller gunboats from the Romanian and Chinese navies. This turned a company whose sales in 1908 were just under \$5,580,000 to one whose sales were \$12,600,000 by 1912. The expanded operations of the company occurred through debt-financing rather than by issuing new stock shares. It, therefore, relied heavily upon its principal banker, the *Creditanstalt* — which strained to keep up with *Stabilimento's* demand for capital. The *Creditanstalt* managed to raise money for *Stabilimento*, but at high rates of interest. *Stabilimento* was able to cover the interest payments only because the naval build-up allowed their net profits to more than double in the four years leading up to 1914.³⁸ The high interest charges absorbed much of the profits *Stabilimento* was making; this turned what should have been a spectacular profit into only marginal gains.

Austria-Hungary was, by 1911, showing all the signs of an economy that was overheating. High interest rates, serious liquidity problems, inflation, and mounting budget and trade deficits alarmed the Austro-Hungarian business community and, subsequently — the Austro-Hungarian leadership. The reaction of the Austro-Hungarian government to the Second Moroccan Crisis in 1911 clearly reflects this. Count Karl Graf von Khuen-Hédéráry, Hungary's prime minister, received much applause from the Hungarian legislature when he claimed that Austria-Hungary had no obligation to come to Germany's assistance over the Moroccan crisis.³⁹ The German ambassador in Vienna recognized these views of the Austro-Hungarian government by summing up their attitude in a despatch back to Berlin:

People here undoubtedly want to treat the Morocco question with great cir-

³⁶ MÄRZ, 30.

³⁷ MÄRZ, 29.

³⁸ MÄRZ, 10.

³⁹ FISCHER, 86.

cumspection and avoid for our sake for as long as possible any differences with the other treaty powers. The reason for this attitude and the support for it comes from public opinion which firmly refuses to be embroiled in a Moroccan adventure. The monarchy also wants to remain on good terms with France with which it has a variety of links particularly in the economic sphere.⁴⁰

Austria-Hungary's hesitation to support Germany stemmed from the fact that French and British banks had begun selling off their Austrian and Hungarian securities at the outset of the crisis.⁴¹ This proved to be a major shock to the gold reserves of several Austro-Hungarian banks and indicated to the Austro-Hungarians that if war did break out, the economy could crumble much quicker than expected. The anxiety caused in the banking community by this event is seen in the Austro-Hungarian Bank's general council meeting on October 25, 1911:

the secretary-general, Pranger, reported that for the first time in decades a loss of confidence in the currency was evident in certain parts of the monarchy. Prime sufferers were the savings banks, where big withdrawals were occurring... Even gloomier was the... [report that] withdrawals from financial institutions had spread like a contagious disease to all parts of the economy. An exodus of capital across the Monarchy's borders was verifiable...⁴².

Many of Austria-Hungary's economic troubles could be traced directly to the international reactions to its political alliance with Germany. Without access to the capital markets of Paris and London (the interest rates in New York remained at most times higher than those of Berlin), Austria-Hungary's economic boom was certain to collapse. Alexander Spitzmüller, Chairman of the Board of Directors of the Creditanstalt, claimed publicly that Austria-Hungary was suffering financially from the alliance with Germany and advocated a political reconciliation with the French.⁴³

The German reaction to Austria-Hungary's hesitation to support it in the Moroccan affair was taken in the form of an unprecedented series of emergency loans totalling over \$200 million from April 1913 to April 1914 alone.⁴⁴ While the loans occurred at a time when German liquidity was at an all-time low (since Germany was floating \$240 million worth of bonds to in-

⁴⁰ "Despatch from Ambassador von Tschirschky und Bogendorff to Berlin", (May 31, 1911); as cited in FISCHER, 86.

⁴¹ MÄRZ, 100. He discusses the French liquidation of their Austrian assets. "Destitution of English Capital", *Economist* (Jan. 4, 1913), 5. This article describes the British lack of confidence in Austria's economy. The article estimates that British capital flows dropped from £4,100,000 in 1910 to £40,000 in 1912.

⁴² MÄRZ, 100.

⁴³ FISCHER, 297.

⁴⁴ FISCHER, 297. Actual figure was quoted at 971.6 million German marks.

crease its own military ⁴⁵), they seem to have temporarily bolstered Austro-Hungarian confidence in the Dual Alliance. On the Vienna bourse, Austrian Crown bonds which had dropped three points over the opening months of 1913, rebounded a point and a half by early May.⁴⁶ This showed a renewed confidence in the Austro-Hungarian economy that was also reflected in improved trade statistics as the trade deficit dropped from \$151 million in 1912 to \$106 million in 1913 as Germany imported more raw materials from Austria-Hungary rather than Russia.⁴⁷

The increase in German financial assistance to Austria-Hungary gave the Austro-Hungarian economy enough of a boost to reaffirm its confidence in the alliance. When the July Crisis occurred in 1914, the effects of Germany's last-ditch effort had not yet worn off. The Austro-Hungarian economy showed enough signs of recovery to silence the critics of the alliance. Austria-Hungary was also in a better position economically in 1914 than it had been during the Second Moroccan Crisis of 1911 to sustain a war effort. Precautions, such as ensuring large gold and currency reserves, had been taken and increasing German financial stringency made it clear that further hesitation could prove disastrous for the economy.

Had not Austro-Hungarian confidence in Germany been restored prior to the July Crisis, Austria-Hungary might have been more willing to resolve the affair through peaceful means. Its differences with France and Britain were not irreconcilable, and those two states might have been able to use their influence to persuade Russia to be more amenable to Austro-Hungarian interests. But with Austria-Hungary's confidence restored in Germany, it was ready to act on any cue Germany might give. In July 1914, Germany was ready for a conflict for a number of political reasons and pledged its support should Austria-Hungary wish to use the July Crisis as a pretext for war.⁴⁸ Austria-Hungary did.

⁴⁵ FISCHER, 357. The German Army bill, which called for a billion mark increase in the Army's budget, was to be financed exclusively by deficit spending. This tightened Berlin money markets even further.

⁴⁶ From a comparison of bond quotes from the Vienna bourse see the bond listings in the *Economist*, (28 Dec., 1912, 11 Jan., 1913, 3 May, 1913, and 17 May, 1913).

⁴⁷ RUDOLPH, 230. Actual figures as stated in Austrian crowns - 743,200,000 crowns for 1912, 521,200,000 crowns for 1913.

⁴⁸ ORLOW, 98.