

Reserve and Vehicle Currencies in the Financial Structures of Hungary, 1924-1931

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The study of the competitive aspects of Europe's post-World War I economic and monetary stabilization has a tradition of at least half a century. William A. Brown's monumental work on the interwar gold standard experience¹ devotes much attention to questions pertaining to Anglo-American and Anglo-French rivalries in the international monetary regime. Competition and co-operation between the Great Powers are among the main themes of such classics in the field as Sir Henry Clay and Lester V. Chandler's biographies of Montagu Norman and Benjamin Strong,² or Stephen V.O. Clarke's work on central bank co-operation.³ The 1970s and early 80s saw the emergence of new problem-definitions and approaches thanks to political scientists⁴ and specialists of international relations.⁵ The element of rivalry has been given stronger emphasis, and additional empirical evidence has been forthcoming concerning the consequences of and reactions to the 'leadership crisis' on the periphery.⁶ However, the nature of the evidence at our disposal is such that it is still inadequate for testing some of the most common and

¹ W.A. Brown, Jr., *The International Gold Standard Reinterpreted 1914-1934*, Vols. I-II (New York: National Bureau of Economic Research, 1940), see especially Chapter 11 in Part II of Book Two.

² Sir Henry Clay, *Lord Norman* (London: Macmillan & Co. & New York: St. Martin's Press, 1957) and L.V. Chandler, *Benjamin Strong, Central Banker* (Washington, D.C.: The Brookings Institution, 1958).

³ S.V.O. Clarke, *Central Bank Co-operation 1924-1931* (New York: Federal Reserve Bank of New York, 1967).

⁴ Susan Strange, *Sterling and British Policy: A Political Study of an International Currency in Decline* (London: Oxford University Press, 1971).

⁵ Benjamin M. Rowland, ed., *Balance of Power or Hegemony: The Interwar Monetary System* (New York University Press, 1976).

⁶ F.C. Costigliola, "Anglo-American Financial Rivalry in the 1920s", *Journal of Economic History*, Vol. XXXVII, No. 4 (December, 1977); György Péteri, "The Inflation-Proof Gold Standard", *The Journal of European Economic History*, Vol. 13, No. 3 (Winter 1984).

elementary assumptions and beliefs upon which contemporary policies (and our own historiography) relied.

The challenge posed by New York to London's international financial leadership was of the most significant features of post-war development. At stake was the relative position of the dollar and sterling in the world's and in Europe's monetary and financial structures after the war. All this is well documented and generously related in the literature. But we can say little or nothing when it comes to the concrete, quantifiable side of the matter. Exactly to what extent did bills drawn on New York and on London help to effect international transactions? What share did the dollar and sterling have in the monetary and other reserves held in various countries? Was Governor Norman correct in assuming (in 1924) that sterling was "the main basis on which European Exchanges are operated"? And did New York successfully follow Paul M. Warburg's advice to take advantage of the "unique opportunity" provided by Europe's monetary stabilizations and consolidate the dollar's position as the key top currency? The answer to these questions is necessarily of an empirical-statistical character. The impressions and beliefs of the actors of the contemporary monetary and financial scene (just as those of today's historians) are in this respect of little relevance.

By taking a closer look at unpublished statistical sources related to the various uses of foreign currencies and exchange in the Hungarian economy during the 1920s, the intention of this paper is to contribute to the foundations upon which answers to the above questions may be grounded. It may be useful to know that the data presented originate from two institutionally different periods of postwar monetary development. Tables 2/W-B (and, to a certain extent, even Table 4) cover a period of centralized foreign-exchange management. There had been no free foreign exchange market in Hungary until early 1925. Especially for the earlier half of the decade, our data can hardly be said to be conclusive. However, the composition of official reserves and of the compulsory private deposits made in connection with the export trade, may, in our judgement, very well serve as indications of prevailing priorities in the country for effecting (or preserving the value of savings) in one or other major currency. I know of no other efforts to present similar statistics concerning any other country or group of countries for the period in question. If and when interwar Europe's monetary history becomes once again as fashionable a topic as it was only ten years ago, we can hope for compilations of a more comprehensive and systematic character than the one presented here.

I believe my collection of data for Hungary, in terms of available sources, is exhaustive. It may be less homogeneous and comprehensive than one would wish, but it still gives a more solid basis for discussing the international roles played by various national currencies in the 1920s than any other sort of information from the period.

Peter Lindert's statistical compilation for the pre-1914 world may be regarded as a model for dealing with the interwar period, for which we still lack

the data. A summary of his findings relevant to our subject is given in Table 1, below. What Lindert's data confirm is that before 1914 Sterling was the world's leading *reserve currency*. In Europe, however, sterling's reserve currency position was inferior to that of the French franc and German mark. The extent of the use of leading currencies to effect international payments cannot be established with the help of Lindert's data. Of course, as a *vehicle currency*, sterling may have held the leadership even in Europe. For, as we shall see, the two types of international use of a leading currency are seldom of the same magnitude.

Table 1⁷
THE COMPOSITION OF THE WORLD'S OFFICIAL
(FISCAL AND MONETARY) FOREIGN EXCHANGE RESERVES, 1913

| | % Foreign Exchange Holdings | | |
|---------------|--------------------------------|----------|----------------|
| | World's | Europe's | Extra-European |
| Sterling | 38.2 | 11.7 | 76.0 |
| French Frs | 24.5 | 39.4 | 3.1 |
| German Mark | 13.3 | 17.5 | 7.3 |
| Other | 5.6 | 6.6 | 4.2 |
| Not specified | 18.4 | 24.8 | 9.4 |
| Total | 100.0 | 100.0 | 100.0 |

Like Austria and Germany, Hungary, one of the newly-created successor states of the defunct Austro-Hungarian Empire, relied heavily on London's support in stabilizing her currency in 1924. Unlike the cases of Vienna and Berlin, however, the support to Budapest was made conditional upon stabilization on a Sterling basis.⁸ The available data concerning the composition of the stocks of foreign exchange held by the Hungarian public and treasury before stabilization reflect the turmoil created in post-war Central European finance. They testify to an increasing role of sterling and the dollar as a reserve

⁷ On the basis of Peter Lindert's data, "Key Currencies and Gold 1900-1913", Princeton Studies in International Finance, No. 24 (August 1969), pp. 18-19.

⁸ Cf. György Péteri, "Tying up a Loose End, British Foreign Economic Strategy in 1924: The Hungarian Stabilization", Acta Historica Academiae Scientiarum Hungaricae 30 (3-4), (1984).

currency, at the expense of the Swiss franc to which a great deal of Central European capital had fled during and immediately after the war.

Table 2/A
"DEVIZEN" AND FOREIGN CURRENCY HOLDINGS
OF THE HUNGARIAN TREASURY HELD
AT THE NOTE INSTITUTE⁹

| Date | (% of total holdings) | | | | | |
|--------|-----------------------|----------|--------|--------|--------|-------|
| | London | New York | Zürich | Berlin | Prague | Paris |
| 220429 | 23.03 | 17.06 | 28.92 | 9.50 | 8.04 | 6.54 |
| 220721 | 8.12 | 11.42 | 19.99 | 1.29 | 7.67 | 42.68 |
| 221023 | 16.50 | 23.28 | 14.50 | 0.35 | 16.12 | 11.19 |

Table 2/B
FOREIGN EXCHANGE LIABILITIES OF THE DEVIZENZENTRALE
TO THE HUNGARIAN PUBLIC

| Date | (% of total of compulsory deposits with the DZ) | | | | |
|--------|---|----------|--------|-----------|--------|
| | London | New York | Zürich | Amsterdam | Prague |
| 231017 | 61.12 | 1.86 | 12.60 | 6.33 | 17.92 |
| 231203 | 62.30 | 2.18 | 13.11 | 6.57 | 15.60 |
| 240307 | 47.42 | 41.92 | 4.73 | 2.13 | 3.71 |
| 240531 | 41.64 | 44.27 | 7.65 | 0.75 | 5.41 |

The data for the 31st of May, 1924, also show that, by the eve of

⁹ Sources for Table 2/A and 2/B: Hungarian National Archives/HNA/, Finance Minister Tibor Kállay's papers, K 275, 6.cs. V/11, Reports on the Treasury's devizen-and foreign currency accounts with the Royal Hungarian State Note Institute, and, for Table 2/B, balances of the Devizenzentrale established to carry out foreign exchange controls during 1923-24. Banks and other firms as well as the Treasury were by law obliged to deposit their foreign exchange holding with the DZ.

stabilization, the US dollar had gained a position within Hungary's foreign exchange reserves well comparable to that of the pound sterling.

A gold (which, at that time, meant dollar-based) currency for Hungary would have led to a further radical shift in favour of New York, there still being more than a year to go before Sterling's parity rate to the dollar (\$ 4.86) and the free gold market in London would be restored. No doubt, Norman's policy of imposing the sterling standard upon Budapest gave sterling a privileged position among Hungary's major reserve currencies. This is borne out by our next table.

Table 3
THE COMPOSITION OF THE FOREIGN EXCHANGE HOLDINGS
OF THE HUNGARIAN NATIONAL BANK, FEBRUARY 1925¹⁰

| (% of total holdings) | | | | | | |
|-----------------------|----------|--------|-----------|--------|-------|-------|
| London | New York | Zürich | Amsterdam | Berlin | Paris | Other |
| 82.81 | 6.22 | 3.48 | 1.02 | 0.06 | 0.04 | 6.37 |

Even considering the multitude of possible temporary (seasonal or shorter-term) factors that may have affected the composition of foreign exchange reserves observed on 7 February 1925, the extent to which sterling prevailed can hardly be explained but by the secret agreement between President Popovics and Governor Norman of 14 June 1924 stipulating the adoption of sterling as the standard of value for the Hungarian currency.

We get, however, a completely different picture if we look at what currencies acted as *vehicles* for Hungarian payments abroad during the early post-stabilization period (Table 4). As Vienna and Berlin, due to war-time and post-war inflation, were no longer safe centres with which to hold "working balances", the bill drawn on Zürich had acquired a significant role in transacting Central European business. We can also see that claims on London, ranking only second after Zürich, had but a negligible advantage over the upcoming US dollar. Europe's growing long-term indebtedness towards the US, combined with the New World's rapidly increasing trade surpluses, and, last but not least, the stability of the dollar in terms of gold made New York, as a major clearing house of the world, a mighty competitor to London indeed.

¹⁰ The data, based on a report of the Central Accountancy of the National Bank, dated February 7, 1925, were included in H.A. Siepmann's letter to M. Norman, Budapest, 17 February 1925, Bank of England, Central Archives, OV 33/38.

Table 4
COMPOSITION OF OUTGOING PAYMENTS OF FOREIGN EXCHANGE,
HUNGARIAN NATIONAL BANK ¹¹

| (% of total flow between July 1 and December 9, 1924) | | | | | |
|---|-----------|----------|----------|----------|-------|
| Zürich | London | New York | Prague | Vienna | Milan |
| 28.2 | 16.2 | 15.6 | 15.1 | 7.8 | 4.2 |
| Bucharest | Amsterdam | Paris | Belgrade | Bruxxels | Other |
| 3.8 | 3.3 | 2.6 | 2.1 | 0.4 | 0.7 |

In the second half of the decade, the Swiss franc proved to be unable to preserve its position either as a reserve or as a vehicle currency, while sterling's leadership was confined to the role of reserve currency. As vehicle currency, both of them had to yield to the irresistible pull exerted by New York.

Table 5
THE RELATIVE POSITION OF SELECTED CURRENCIES IN THE
RESERVES/OUTGOING PAYMENTS OF THE HUNGARIAN NATIONAL
BANK ¹² 1929/30

| | (average stock/flow of Sterling = 1) | | | |
|----------|--------------------------------------|-----------|--------------|--------------|
| | Pound Sterling | US Dollar | Swiss Francs | Czech Crowns |
| Reserves | 1.00 | 0.90 | 0.21 | 0.07 |
| Payments | 1.00 | 1.39 | 0.19 | 0.08 |

¹¹ Source: H.A. Siepmann / League of Nation's adviser to the Hungarian National Bank, 1924-26/, Memorandum (handwritten, undated), BECA OV 33/38.

¹² Data base on the items of the so-called Current Account Books for US dollar, pound sterling, Swiss francs and Czech crowns of the Central Accountancy of the Hungarian National Bank, for the period between 1 January 1929 and 31 December 1930 (Hungarian National Archives).

The short-term foreign indebtedness accumulated by Hungary's commercial banks (and comprising the bulk of the economy's short-term foreign indebtedness as a whole) reflect more sharply than the central bank reserves the advance of the dollar into a predominant position in the country's financial structures. On the basis of an agreement in mid-1926 between the National Bank and the leading commercial banks, the latter undertook regularly to provide monetary management with detailed data concerning their short-term foreign debts. After 1931 the practice of regular reporting was discontinued, but in 1935 a survey was made by the National Bank's intelligence department. On this occasion data concerning the status of the banks obtained on 31 August 1931 were collected too. The complete original set of the banks' reports has been preserved in the National Bank's files¹³, and the data contained in them have been processed to produce the table below.

Table 6
COMPOSITION OF HUNGARIAN BANKS' SHORT-TERM FOREIGN
DEBITS, 1931
(%)

| | A Creditor | B Currency | B-A |
|-----------------------|---------------|---------------|---------|
| USA/US Dollar | 30.40 | 47.45 | + 17.05 |
| UK/Pound Sterling | 21.00 | 24.20 | + 3.20 |
| France/French Frs | 8.06 | 6.15 | — 1.91 |
| Switzerland/Swiss Frs | 14.58 | 5.78 | — 8.80 |
| Other | 25.96 | 16.42 | — 9.54 |
| Total | 100.00 | 100.00 | 0.00 |

The statistics above enable us to identify not only the USA as the domicile of the most important single group of short-term creditors of Hungary, but also, and more significantly, the US dollar as the value in which almost half of the

¹³ The reports of the 19 banks provided detailed data (in altogether 916 cases) concerning the amount, currency and legal form of their short-term foreign debts as well as concerning the nationality of the creditors. The reports are held in the Hungarian National Archives, among the files of the intelligence department of the national Bank (Z 12, 201.t.). I am indebted to Dr Zsuzsa Galasi of the National Archives, Budapest, for the invaluable help she provided in tracing these reports.

country's short-term debts were contracted. The direction and degree of discrepancy between the composition according to creditors' nationality on the third column of Table 6 reveal the fact that the extent of the use of the dollar as a means of international payments went far beyond the confines defined by the volume of transactions in which US nationals were involved. By the year of the financial crisis, the US dollar had in fact become a key currency in Hungary's (and, quite probably, in the whole of Central Europe's) monetary and financial life. Without the economic-commercial strength underlying her pre-1914 international financial supremacy, Britain had been unable to consolidate sterling's position in the region. Paul M. Warburg's prophecy of early 1924 seemed to have come true: "for many years to come — he tried to convince the Swedish central banker, Victor Moll — the gold holding of the United States will ... serve as the basis not only of Uncle Sam's monetary system, but of a great many other countries' all over the world. That is the picture which I have of the future ... I see the United States as the primary gold pivot of the world".¹⁴ But this was a short-lived victory. The crisis of 1931 led to the collapse of the international gold (gold-exchange) standard regime, and, within a short time, the agrarian economies of Central and Eastern Europe found themselves tied to Germany through that ingenious innovation of Dr. Reisch, bilateral clearing.

¹⁴ Paul M. Warburg to Victor Moll, February 4, 1924, Archives of the Swedish Riksbank, Stockholm, Förste deputeraden V. Molls korrespondens.