Chapter 4

The role of the state in promoting economic development: the Russian case and its general implications

Paul R.Gregory

INTRODUCTION

This chapter studies the role of the state in dealing with Russian relative backwardness. Russia is used as a case study because of Alexander Gerschenkron's view that the Russian state substituted for missing preconditions. The chapter considers three forms of state involvement: constitutional change in agriculture, monetary and fiscal policy, and direct entrepreneurial activities. The chapter concludes that Gerschenkron's assessment of constitutional change in agriculture has proven to be seriously flawed and that the Russian state's entrepreneurial activities were minimal. The major success of Russian industrialization was the attraction of sufficient foreign investment to achieve high investment rates for a low-income country. While the state provided a stable monetary and fiscal framework, foreign capital was attracted principally by the private profit opportunities in Russia.

In assessing the role of the Russian state, Gerschenkron assumed that the provisions of the 1861 peasant emancipation would be adhered to even though they violated private profit incentives. He also assumed that the 'enlightened industrial policy' strategy outlined by Witte was actually implemented by the Russian state.

THE GERSCHENKRON PARADIGM

Alexander Gerschenkron sought to explain what he perceived to be an empirical regularity of the nineteenth century. Latecomer countries, such as Germany, Russia, Japan and Italy, experienced rapid spurts in their rates of economic growth that exceeded those of the countries that had industrialized before them. Gerschenkron used the theory of relative backwardness to explain why economies that had previously languished should suddenly experience growth accelerations (Gerschenkron 1962: essay 1, 1963, 1965).

As modern economic growth spread from England to Germany, France, the United States, and elsewhere, countries with development potential that failed to participate in modern economic growth became relatively backward. In

1850 Russia's per capita income was about half that of France and Germany and about one-quarter of England's. Some thirty years later, Russia's per capita income had dropped to one-third that of France and Germany and to about 15 per cent of England's. During the same period, Italy declined from per capita income parity to around three-quarters of the level in France and Germany (from Mitchell 1976: B1, K1; Gregory 1982:155).

Gerschenkron felt that economic slippage in countries that had been competitive with now more-advanced rivals made them ripe for growth acceleration. Countries newly caught in a state of relative backwardness were under pressure to close the economic gap between themselves and their rivals.

Those countries that first experienced modern economic growth did so because of favourable preconditions (Rostow 1965). England experienced modern economic growth first because it had built up a constitutional democracy, a social infrastructure, an entrepreneurial middle class, and a track record of domestic capital formation. Almost by definition, relatively backward countries were backward because they lacked the preconditions for modern economic growth.

Gerschenkron sought to explain why nineteenth-century follower countries such as Germany, Russia and Italy—countries that lacked many preconditions—began to experience growth accelerations. After all, preconditions cannot be created overnight. Gerschenkron argued that relatively backward countries can create conditions for rapid growth by *substituting* for missing preconditions. If there is no middle class to supply entrepreneurs, foreign entrepreneurs can be used. If a skilled labour force is lacking, capital-intensive machinery can be substituted. If domestic capital formation is deficient, state capital formation or foreign saving can be used in its place (Gerschenkron 1968, 1970, lecture 4).

Nineteenth-century Russia was Gerschenkron's example par excellence of how relatively backward countries can use *and* misuse the state to accelerate economic development. He believed that although the Russian state achieved notable successes in promoting industrial growth, its failure to create an appropriate constitutional framework in agriculture caused the overall failure of Russian industrialization.[1]

The about-face of Russian state policy

Gerschenkron believed that the Russian state actually sought to impede economic development prior to its 'about-face' in the 1850s. In the Russian feudal autocracy, power was exercised by the tsar through advisors, relatives and ministers. The affairs of state were entrusted to a bureaucracy that was large for a relatively backward country but often lacking in professional competence.[2] Russian bureaucrats issued patents and licences, collected sales and excise taxes, managed the affairs of the court, supervised state and crown lands, ran the legal system, levied tariffs, collected statistics, and managed state enterprises.

The ruling élite was convinced of the virtue of feudal agriculture. The feudal lord used the village commune to police the unruly peasantry, restrict peasant mobility, collect agricultural taxes, and provide military recruits. Prior to the about-face of the 1850s, the Russian state feared that industrialization and modernization would concentrate revolution-minded workers in cities, railways would give them mobility, and education would create opposition to the monarchy.

Russia's backward feudal system served the ruling élite well until the 1850s, despite massive peasant uprisings. Russia's manpower advantage and vast territories had repelled Napoleon. The lack of railroads made it difficult for foreign invaders to penetrate the Russian homeland, and Russia's artillery was not notably inferior to Western Europe's at the turn of the nineteenth century.

Gerschenkron dates the about-face of Russian state industrial policy to the loss of the Crimean war (1853–6) to France, England, Turkey and Sardinia. The accession of Tsar Alexander II in 1855 and the capture of Sevastopol led to the Treaty of Paris that ended the dominant role of Russia in southeast Europe. The Crimean war confronted the Russian leadership for the first time with its economic inferiority *vis-à-vis* France and England.

The shock of relative backwardness forced the Russian state to turn its attention to catching up with Western Europe before Russia became a second-rate power in Europe. According to Gerschenkron, the about-face of state policy created new industrialization opportunities. With a powerful state bureaucracy dedicated rather than opposed to industrialization, Russia had—for the first time—a real opportunity to deal with its relative backwardness.

Gerschenkron looked at three types of state action that were available to the Russian ruling élite to overcome Russia's growing relative backwardness: (1) constitutional changes to provide appropriate property rights for economic development; (2) monetary and fiscal actions to create a financial and trade climate for economic development; and (3) state entrepreneurial actions to substitute for missing entrepreneurship. He concluded that the Russian state failed in the area of agrarian property rights, whereas it achieved notable successes in the other two areas. It was the failure in the constitutional area that caused Russian development to be halted by revolution and recession at the turn of the century, at which time more appropriate agrarian property rights were adopted.

Constitutional changes in property rights

England's head start in modern economic growth was aided by the early creation of a legal and constitutional framework that supported private property rights and sanctity of contract. Prior to the about-face of the 1850s, Gerschenkron felt that Russia's constitutional framework actively inhibited economic development. The vast majority of Russia's population lacked juridical freedom. Serfs could be bought and sold; they lacked the basic personal and economic rights that were taken for granted in Western Europe. Russian serfdom was based on compulsory labour obligations in the richer agricultural regions and on quit-rents in the steppes. The Russian village was run by a village self-government that handled matters of policing, tax collection, land distribution, family disputes and military recruitment. The three major owners of land—the gentry, the church, and the crown—all relied on serf labour to farm their lands. Private small-scale agriculture was lacking except on the periphery.

The about-face of the 1850s forced the Russian leadership to conclude that constitutional changes in agriculture were necessary. The tsar concluded that the initiative had to come quickly from above (in view of the strength of gentry opposition to emancipation) before the peasants took matters into their own hands from below.

The emancipation mistake

Gerschenkron felt that, if serfdom could have been replaced by private farming in Russia, the major obstacle to Russia's long-term economic development would have been removed, and Russian history would have been altered. It was the failure to create private peasant property rights in 1861 that doomed the state's other actions to overcome relative backwardness.

In an autocracy dominated by landed interests, serf emancipation required compensation not only for the land ceded to former serfs but also for lost labour services or quit-rents. The 1861 emancipation granted the gentry such compensation with an implicit payment for lost labour services in the form of overvalued land prices. The peasants, who had expected outright ownership, were saddled with redemption payments that were to amortize the land over nearly a half century's time. Moreover, the peasants ended up with less land, on average, than they had cultivated under feudal arrangements.

The 1861 Emancipation Act decreed that land be distributed to the village commune, not to individual peasant families. The emancipation retained the village commune to manage land allocation and redistribution, policing, and tax collection. Peasant families were made collectively responsible for the debts of the commune. Responsible households had to step in to cover for free-riders.

The peasants received their juridical freedom but not their economic freedom. They could not withdraw their land from the commune without paying off their share of the debt, and as long as their land remained within the commune, peasants could not make their own resource allocation decisions. Moreover, with periodic redistributions of land, adult family members had to stay in agriculture to ensure the peasant family's share of communal land. Furthermore, periodic redistributions penalized families that had made capital improvements on their plots of land.

The formal provisions of the 1861 Emancipation Act were not promising judged from an economic point of view. Gerschenkron concluded that the 1861 emancipation made balanced growth of the Russian economy an impossibility. The commune tied labour to agriculture and created the paradox of a labour-rich country starved for industrial labour. The inadequate land distribution of the emancipation left peasant families with inefficiently scaled plots. The retention of communal agriculture—and the lack of development of private farming—meant that productivity advances in agriculture would be minimal. The debt burden placed on the peasantry by the overstated land prices meant that there would be insufficient private demand to support industrialization.

Monetary and fiscal policy

Russia's monetary and fiscal policies were to a great extent dictated by the desire to join the international gold standard. In Russia's case, a remarkable series of influential finance ministers pursued a consistent fiscal policy of budgetary surpluses and limited monetary growth to create a stable currency on international currency markets. After more than two decades of stringency, the Russian credit ruble was trading at a fixed rate of exchange to the gold ruble, and Russia officially went on the gold standard in 1897.

The Russian state was not alone in directing its monetary and fiscal policies to the international gold standard. It appeared to be the thing that respectable countries did at the end of the nineteenth century (Yeager 1984:651–70). The peculiar significance Gerschenkron attaches to Russian monetary and fiscal policies of the last quarter of the nineteenth century was that monetary stability was deliberately pursued to attract foreign capital. In a famous policy paper, Finance Minister Sergei Witte spelled out the importance of foreign capital in light of Russia's deficient domestic saving capacity (Von Laue 1954, 1963). Unlike other countries that pursued monetary stability and accumulated gold reserves to achieve convertibility, Russia did so expressly to substitute for a missing precondition—the lack of domestic saving.

According to Gerschenkron, Russia's monetary and fiscal conservatism paid off handsomely. Prior to the turn of the century, considerable direct foreign investment was attracted, bonds were successfully floated in the European money markets to finance railroad construction, and foreign entrepreneurs were attracted to Russia in large numbers. The Russian investment rate was pushed up by an influx of foreign saving and also by public saving from the state budget.

The state as entrepreneur

Constitutional and monetary and fiscal policy actions are common to all states. They do not involve an unusual substitution of the state for missing preconditions. Gerschenkron saw the unique state role in the Russian case to be the substitution of the state bureaucracy for missing entrepreneurship.

According to Gerschenkron, the Russian state followed what would now be called an enlightened 'industrial policy' which he felt contributed significantly to Russian industrialization. The state managed construction of state-owned railroad lines and guaranteed loans to private railway lines. The state assisted in floating foreign-currency loans in European credit markets. The state reserved steel, military and railway equipment contracts for domestic industry, while pursuing anti-union policies. The state erected tariff barriers that increased the demand for domestic goods and attracted foreign direct investment behind Russian tariff walls. Moreover, the state engaged in a public relations campaign to attract Western entrepreneurs and craftsmen to Russia. The state granted licences to foreign companies that wished to do business in Russia.

Gerschenkron felt that the Russian state had to substitute its own demand for private demand. The backwardness imposed on Russia by communal agriculture meant that domestic demand for the products of Russian industry was deficient. By directing state purchases to domestic producers, the Russian state substituted state demand for private domestic demand. By placing a heavy fiscal burden on the peasantry and by generating surpluses from state-owned monopolies, state budgetary surpluses compensated for deficient private saving. By creating a stable environment for foreign investment, state monetary and fiscal policies attracted foreign saving to serve as a further substitute for deficient domestic saving.

The outcome according to Gerschenkron

The outcome of state activities was a spurt in the rate of industrial growth beginning in the mid-1880s.[3] While industrial growth was proceeding at a rapid pace, agriculture remained in an 'agrarian crisis'. Per capita agricultural output was actually declining. The tying of peasants to the land created rural over-population. Russian industry was forced to adopt capital-intensive factor proportions to make up for the scarcity of labour in a labour-rich country. Peasant 'land hunger' was evidenced by soaring land prices and land rents. The Russian agrarian crisis exhausted the tax-paying capacity of the Russian peasant, and the state system of generating fiscal surpluses could not be maintained.

The Russian agrarian crisis, coupled with world recessions, culminated in the 1905 revolution which shook both agriculture and industry. The 1905 revolution finally convinced the Russian leadership that the commune had to be abandoned in favour of private agriculture. The Stolypin Reforms of 1906 and 1910 cancelled peasant tax obligations and gave peasant families freedom to withdraw from the commune. These favourable changes set off a new wave of more balanced economic development. The outbreak of the First World War interrupted this second advance. No one knows what would have happened had Russian economic development been allowed to proceed on this more solid footing without interruption by the First World War.

The appeal of the Gerschenkron model

Gerschenkron's analysis of the economic development of tsarist Russia after the 1861 emancipation remains the most widely accepted version of Russian industrialization. What explains its continuing popularity? First, it offers a feasible explanation for the acceleration in Russian industrial growth in the 1880s. Second, it offers an optimistic view of the role of the state—the view that a state can use industrial policy to substitute for missing preconditions. Third, it offers a plausible explanation of political events. The Gerschenkron model explains the 1905 revolution in terms of the growing disequilibrium between industry and agriculture and the exhaustion of the Russian peasantry, drowning under the burdens imposed by the disastrous peasant emancipation. Fourth, it offers an appealing view of an alternate democratic Russian society in the twentieth century—a society that had finally found the key to pluralistic economic development based on private agriculture and enlightened state industrial policy.

GERSCHENKRON AND THE TEST OF TIME

Gerschenkron set the research agenda for economic historians studying the follower countries. Much scholarly effort has gone into examining his propositions. Students of Russian economic history have engaged in considerable research on Gerschenkron's interpretation of Russian economic history, especially his view of the state and Russian economic development. Some of Gerschenkron's insights have withstood the test of time. Others have not.

Overestimation of the effect of constitutional rules

The Gerschenkron model emphasizes the long-run damage inflicted by the 1861 emancipation. The retention of communal agriculture combined with the oppressive peasant debt burden meant that agriculture could not contribute to economic development either through productivity or demand increases.

Gerschenkron interpreted the emancipation law literally. He assumed that the state through its national and local representatives enforced rules that reduced profit opportunities in both agriculture and industry. Subsequent research has called this assumption into serious question.

Research on the post-emancipation period concludes that Russian peasant agriculture operated with much more flexibility than allowed by the formal letter of the law. Internal passport data and industrial labour force statistics reveal that the Russian peasant moved rather freely between agriculture and industry, despite the commune's restrictions on such mobility (Gregory 1974a; Crisp 1976). Despite their nominal rural ties, peasants several generations away from the countryside were engaged in work in Russian factories (Gatrell 1986: ch. 3 and 4). The growth of the industrial labour force in the 1880s was equal to or exceeded that of the United States during its period of most rapid expansion. Gerschenkron had argued that communal restrictions on peasant mobility forced the substitution of artificially capital-intensive factor proportions on Russian industry. This argument appears to be supported by Lenin's statistical study of Russian large-scale industry.[4] Olga Crisp has shown that the apparent high capital intensity of Russian industry may be the consequence of the peculiar reporting system of Russian factory statistics. Recent Soviet studies of industrial concentration may ultimately shed light on this issue, but we lack a comparative basis for judging relative capital intensity.[5]

The key point remains that Gerschenkron's justification for excessive capital intensity—the freezing of labour on the land—appears to be absent.

The most convincing evidence against Gerschenkron's agricultural stagnation thesis is the relatively rapid per capita growth of Russian agriculture from 1885 to 1913. Productivity advances achieved by Russian agriculture were equivalent to those of Western Europe—as shown by different studies of Russian agriculture (Liashchenko 1908; Gregory 1982: ch. 6, 1984:21–31; Gatrell 1986: ch. 4; Goldsmith 1961). Moreover, peasant real living standards advanced at a rate comparable to the rest of Western Europen (Gregory 1980:135–64).

Why did Gerschenkron miss the mark with respect to his assessment of Russian agriculture? First, the central black earth region on which much attention focused was definitely in a state of long-term decline. In this area, agricultural output per capita was likely declining, and former peasants were turning from agriculture to industrial and handicraft pursuits. Yet much of the contemporary statistical work of the *zemstvos* and anecdotal evidence were being drawn from these declining regions.[6] Moreover, nineteenth-century observers were convinced that an agrarian crisis was in progress, despite contemporary aggregative statistics that showed nationwide per capita agricultural growth.

Gerschenkron's interpretations of rising land prices and of rising marketings appear curious. He argued that rising land prices were a sign of peasant distress because of the cost pressure they placed on peasant households. Similarly, he interpreted rising peasant marketings as being 'forced' from the peasants by their high tax burden. I view both phenomena differently: Rising land prices and rising land rents, as rent theory would assert, are more suggestive of rising marginal revenue product than of agricultural stagnation. Rising marketings are more a sign of market integration and of rising peasant prosperity than of oppressive taxes (Gregory 1987).

If post-emancipation agriculture had adhered strictly to the formal emancipation provisions, agricultural stagnation would indeed have been a likely result. It appears that Gerschenkron underestimated the ability of Russian peasants to circumvent the anti-productivity provisions of the emancipation. Evidence suggests that peasants adjusted their tax payments to harvests. Commune taxes were dealt with on an ability to pay principle, and a series of side payments were instituted to compensate for productivity improvements and land transfers.[7] Although the emancipation act did not give formal property rights to peasant households, it appears that informal property rights emerged. Moreover, the land market showed considerable fluidity with substantial changes in land ownership during this period (Gatrell 1986: ch. 4).

When peasants were given the opportunity to leave the commune in 1907, the rate of departure was surprisingly slow as noted by Gerschenkron. It may well be that the changes in state policy towards communal agriculture (which Gerschenkron pictured as forced upon the leadership by the agrarian crisis) were *de facto* recognition of the informal arrangements that were increasingly practised in Russian peasant agriculture. Even Lenin (1977: ch. 2) emphasized the great diversity of arrangements in Russian agriculture.

Gerschenkron also underestimated the strength of the Russian empire's agricultural periphery. Since the eighteenth century, agriculture had been relatively free of feudal restrictions on the rapidly expanding periphery, leaving Russian peasants free to 'vote with their feet' against the Russian commune (Kahan 1985: ch. 2). Agricultural growth on the periphery exceeded growth in the fifty European provinces, thereby pulling up total agricultural output (Gregory 1982: app. D; Gatrell 1986: ch. 3 and 4).

Gerschenkron's assumption of declining per capita output caused him to anticipate the substitution of state demand for the declining private demand of peasant agriculture. Despite Gerschenkron's claims that Russia's industrial structure was 'top heavy' in favour of heavy industry, comparative statistics reveal that Russian industry was actually 'top heavy' in light industry (particularly textiles) for a country of Russia's size and resource base (Gregory 1974b; 520–7). The lack of substitution of state for private demand is what one would expect if per capita income was growing in agriculture, as the aggregative statistics show.

Monetary and fiscal policy role

Gerschenkron's conclusion that monetary and fiscal policy contributed appreciably to Russian industrial growth has withstood the test of time better than his propositions concerning the effects of constitutional change or agriculture. By comparative standards, Russia attracted an unusually high proportion of domestic capital formation through foreign saving. Indeed, the two unusual features of the composition of Russian national income were its high rate of capital formation and its high rate of foreign saving (Gregory 1976a, b). With Russia's limited domestic capital markets, it is unlikely that Russia could have achieved its relatively high rates of domestic capital formation without foreign saving.

Little attention has focused on the role of state saving, especially during the period of railroad construction. Gerschenkron felt that budgetary surpluses were substituted for deficient personal saving. Russian budgetary practices of the period are difficult to follow, but the 'extraordinary expenditures' devoted to railroad and port construction can be construed as in-kind public saving. Using this accounting procedure, public saving accounted for slightly less than 10 per cent of net investment in both 1885 and 1897.[8] While public saving accounted for some 10 per cent, foreign saving accounted for 15–20 per cent during the same period (Gregory 1982: table 3–2).

Gerschenkron's favourable assessment of Russian monetary and fiscal policy has been challenged by Arcadius Kahan (1967) and Haim Barkai (1973:339–71), who have emphasized the high opportunity costs of monetary stringency. Yet evidence on the growth of foreign investment that accompanied conservative monetary and fiscal policies, combined with the fact that price flexibility was sufficient to neutralize the real effects of monetary stringency, suggests that the benefits of monetary and fiscal conservatism outweighed their costs (Gregory and Sailors 1976).

One of Gerschenkron's minor assertions appears not to have withstood the test of time. There is little evidence of the shift from direct to portfolio investment after the turn of the century that Gerschenkron had perceived (Gregory 1976b).

It is impossible to estimate how large foreign savings would have been to a Russia whose exchange rate was subject to large fluctuations. Whether foreign investors were sufficiently sophisticated at hedging in foreign exchange markets is not known. It may be that the major benefit of monetary and fiscal conservatism was that it gave the appearance of political stability to a regime that—as events demonstrated—was not stable.

State as entrepreneur

Gerschenkron's true interest in the Russian state was in the state as an ersatz entrepreneur. In the Russian case, the secret memorandum of Witte spells out a coherent entrepreneurial role for the Russian state. As in the case of the 1861 emancipation, I believe that Gerschenkron erred in mistaking intent for actual policy.

Arcadius Kahan (1967), in his noted analysis of Russian state budgets, has ably pointed out that there was a notable lack of industrial subsidies in Russian state budgets. An active industrial policy calls for subsidies of industries selected by the state for development. In the Russian budget, there are no notable industrial subsidies. The only 'industrial policy' items that show up in the state budget are loan guarantees for private railway construction and some minor expenditures on ports and military equipment. State expenditures for military hardware made up such a small proportion of the total that the military budget could not have served as a significant vehicle for hidden subsidization (Gregory 1982: app. F).

State enterprises, which could have served as vehicles for state entrepreneurship, did not appear to play an important role in Russian industrialization. State budgets identify state-owned railroads, the postal and telegraph systems, and the state spirit monopoly as the only significant state enterprises. Although railroads played a key role in Russian industrialization, it is not clear that the role of the state was more prominent in the Russian case than elsewhere.[9] With the exception of national railroads, Russian state enterprises were either those that were typically state-owned or, such as the spirit monopoly, were not the 'high-tech' industries associated with enlightened industrial policy.

Moreover, there appears to be a consensus that Russian state tariff policy was dictated by revenue needs rather than by a coherent industrial policy. There is no evidence of discretionary tariffs to favour specific industries or to encourage foreign industries to locate behind Russian tariff walls (Pokrovsky 1902; Kahan 1967; Gatrell 1986:165–7). Manufacturing inputs were taxed at the same rates as manufactures. In fact, foreign manufacturers, seeking to penetrate Russian markets, paid remarkably little attention to lobbying for tariff reductions on the grounds that revenue requirements made changes impossible. Foreign manufacturers appeared to be more interested in their monopoly power in Russian markets, which would allow them to pass the tariff on to the Russian consumer (Kirchner 1986).

The role of state officials in attracting foreign capital is another entrepreneurial function emphasized by Gerschenkron. The image of political and financial stability engendered by Russian officialdom was indeed important to attracting foreign capital, but there is disagreement on its effect on foreign capital. John McKay (1970) has demonstrated that foreign capital was attracted primarily by higher rates of return, not by lobbying efforts of Russian bureaucrats. Interest rate differentials do indeed appear to explain capital movements into Russia (Gregory 1976b). Russia in the late nineteenth century was regarded as a land of unlimited economic opportunity, albeit a market with considerable risks.

Case studies of foreign investments in Russia show that the Russian state was regarded more as an impediment than as a source of assistance (see, for example, Kirchner 1986). Foreign concerns had to learn how to deal with the Byzantine Russian bureaucracy. Bureaucrats had to be bribed as a matter of course, and learning how to deal effectively with the bureaucracy and to find important patrons could take years of effort. In the German case, few companies earned quick and easy profits (Kirchner 1986). Primarily those companies that made long-term investments were those that earned long-term profits in Russian markets.

In defence of the Russian state bureaucracy, it should be noted that the bribes paid to Russian officials did not appear to be very significant. Moreover, the Russian bureaucracy appeared to grant licences primarily on the basis of merit. Companies that were the world leaders in their industries were typically licensed by the Russian bureaucracy, who may have been playing a conservative game by going with proven concerns. A listing of foreign concerns licensed to operate in Russian markets would include an honour roll of the best European and American firms of the day. It does appear that the Russian bureaucracy failed to engender competition by restricting licensing to single companies rather than using multiple licences to promote competition.

The legal role that Gerschenkron failed to deal with adequately was the gradual emergence of the limited liability corporations, a development that made industrial capital formation possible and served to attract foreign capital. Many fortunes were lost prior to limited liability, and risks to Russian entrepreneurs were exceptional in the eighteenth and early nineteenth centuries. Thomas Owen (1983) has chronicled the gradual changes in Russian commercial law and the ambivalent attitude of the Russian bureaucracy towards the corporation.

RETROSPECTIVE ASSESSMENT

Gerschenkron's main error in his assessment of Russian state involvement was his equation of intent with reality. Gerschenkron was fascinated by the coherent statement of industrial policy presented to the tsar by his top economic official, Count Witte. Gerschenkron was also perturbed by the anti-productivity features of the 1861 emancipation, which he interpreted literally. Gerschenkron overestimated the ability of the Russian state to enforce laws and constitutional rules in agriculture. Despite a large bureaucracy, it would nonetheless have been a notable achievement if this bureaucracy could have enforced provisions that worked against the economic interests of both peasants and industrialists. The credible performance of Russian agriculture in the post-emancipation era represents the major source of evidence against the Gerschenkron Russian model.

Subsequent research has failed to uncover significant direct entrepreneurial substitutions of the state for missing private entrepreneurs. On close inspection, one cannot find well-defined entrepreneurial activities of the state. Tariffs were set for revenue purposes, not by enlightened industrial policy. State involvement in railroad construction and management was, of course, a vital state activity, but it remains to be demonstrated that Russian state involvement was significantly different from state involvement in other countries.

The striking feature of Russian industrialization was the importance of foreign saving and foreign entrepreneurship. The influx of foreign saving allowed the achievement of relatively high investment rates in a country in which a domestic capital market was largely lacking. The influx of foreign entrepreneurs undoubtedly had a significant positive effect on technological progress in industry. Yet the Russian state's contribution to attracting foreign capital is unclear. It is clear that fiscal and monetary conservatism created a stable currency. The evidence, however, is persuasive that foreign capital was principally attracted by higher rates of return in private markets. Preliminary analysis of Russian state budgets suggests that public saving was indeed a source of investment finance, accounting for approximately 10 per cent of net investment during the 1880s and 1890s. The Russian state was indeed able to substitute public saving for private saving.

IMPLICATIONS FOR OTHER EUROPEAN COUNTRIES

Gerschenkron's analysis of the Russian case provides the most detailed case study of the role of the state in nineteenth- and early twentieth-century European economic growth. What lessons are to be learned from Gerschenkron that apply to the other European follower countries?

First, Gerschenkron's writings show the pitfalls of confusing intent with the reality of state economic policy. Although the Russian state enacted constitutional changes designed to create a desired set of organizational arrangements in agriculture, profit-oriented individuals were able to circumvent these provisions and create organizational arrangements that differed from the state's intent. The contemporary economic literatures on regulation and public finance show the ease with which laws and regulations that work counter to the profit interests of individuals can be circumvented. The Russian economic bureaucracy operated in a world of primitive information, vast distances, and inadequate official rewards. For laws and legislative intent to find actual translation into economic reality would have been a remarkable achievement for this bureaucracy.

Second, Gerschenkron's model of the state carries with it the intellectual imprint of the late 1940s and early 1950s. To an extent, it reflects the dominant belief expressed in the development literature of the 1950s that the state must assist follower countries in overcoming their relative backwardness. Private markets had 'failed' to create economic development; therefore, the state had to step in to replace private markets. The imprint of Keynes is also clear: inadequate demand was viewed as a source of relative backwardness, and state expenditures could serve as a substitute for inadequate private demand.

Modern public choice literature supplies a more sceptical view of the state's potential role in promoting economic development. Bureaucrats are viewed as self-interested individuals; political coalitions strike deals that are contrary to the national interest and so on. Moreover, even in cases where the state truly desires to promote general economic welfare—through an optimal tariff—the information requirements of devising optimal state policy are overwhelming.

My own research points out that the application of the Keynesian model to nineteenth-century European economies is invalid due to the considerable wage and price flexibility of this era (Gregory and Sailors 1976). The classical model would appear the more legitimate model than a Keynesian model for nineteenth-century Europe, and concerns over inadequate demand should be accorded less importance than concerns over capital formation and productivity improvements. Moreover, the Russian state indeed showed clear signs of the modern public choice model of state behaviour. The drafters of tariff policy considered only the revenue implications of tariffs; little or no thought was given to optimal tariffs or to tariff policies designed to implement specific industrial policies. State purchasing policies were tailored to favour vested political interests.

Third, the Gerschenkron model of the state consistently failed to recognize that the search for private profit opportunities dominated the effects of state activities. Studies of international capital flows during the nineteenth and early twentieth centuries agree that rate-of-return differentials were the dominant force in dictating capital flows. Any model that argues otherwise—namely that international capital flows depend upon state identification and recruitment—misses the mark.

Fourth, the Russian case prior to the 1850s probably was a unique example of a state policy designed to impede rather than promote economic development. If Gerschenkron's assessment of Russian state policy is accurate—particularly the state's anti-education stance and its opposition to railroad construction—then likely the most important state role in Russian industrialization was the abandonment of its anti-industrialization stance. This passive view of the Russian state's role differs dramatically from Gerschenkron's emphasis on the active role of the state in promoting industrialization.

Fifth, Gerschenkron's emphasis on state monetary and fiscal policy should have broad applicability to other European countries. The creation of a stable monetary and fiscal framework provided public capital for railway construction and foreign capital for industrial investment. In the Russian case, the long-run effects of a stable monetary and fiscal framework can be roughly estimated in terms of the increment to domestic capital formation. Similar studies should be done for the other European follower countries to assess the roles of monetary and fiscal policy in domestic capital formation.

NOTES

1 This view is expressed most forcefully in Gerschenkron (1965).
2 Surprisingly little information is available on the size and composition of the Russian bureaucracy. For the best source, see Zaionchkovski (1978).
3 This growth spurt has been found both by Alexander Gerschenkron (1947) and by Raymond Goldsmith (1961).
4 Crisp (1976) disputes Gerschenkron's interpretation of Russian industrial concentration statistics.
5 Bovykin (1984) provides valuable new data on industrial concentration that are suitable for international comparison. This work remains to be done but should shed light on Gerschenkron's hypothesis.
6 For a discussion of regional differentiation, the use of anecdotal evidence, and the consensus concerning an agrarian crisis, see Gregory (1987).
7 The assumption that Russian peasants were not economically rational has its tradition in the writings of Chayanov on peasant economy. See Chayanov (1966). Evidence on the ability of the Russian commune to respond rationally to economic conditions is presented in Gregory (1987).
8 These data are from official budgetary sources summarized in *Statisticheski sbornik svedenii po Rossii za 1884–1885,* Petersburg, 1887, pp. 183–184; *Entwurf des Reichsbudgets für das Jahr 1898,* Petersburg, 1897; Gregory (1982: table 3–2).
9 Crisp (1976) argues that the railroads were much more important to Russian industrialization than the peasant emancipation or other factors.

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Chapter 5

Europe in an American mirror: reflections on industrialization and ideology

William N.Parker

DEMOCRACY AND CAPITALISM

The term 'an old-fashioned American'—and almost every American who has passed a certain age finds moments when he claims to be one—contains, as an Hegelian would suspect, an internal contradiction. An old-fashioned American likes things big, and done in a big way. But in the nineteenth century this was a vice shared with the entire élite of Europe in that period, in politics, in business enterprise, even in literature. What else was the unification of Italy and Germany but a tidying up of the history of those peoples into nation states, the sweeping away of ridiculous, fussy, 'petty' principalities, of lesser and impotent local sovereignties? How else to explain the death-grip of the Hapsburg Monarchy on southeastern Europe, the determined, ruthless power of the tsarist army and bureaucracy over the peoples of Eurasia, the imperialism—cultural and political—of a centralized French Republic, and of course, Britain.

> Wider still and wider
> Shall thy bounds be set;
> God who made thee mighty,
> Make thee mightier yet.

goes the patriotic British song, as law, Christianity, morality, and free trade were carried by the British navy and regiments to the five continents and most of the intervening islands (except, significantly, the Japanese archipelago).

In North America, between Canada and Mexico—those outposts, respectively, of Scotland and Spain—the experiment of government in a republican form, extending itself to the continental scale without fragmentation and without collapse, like its Roman predecessor, into absolutism, continued to be played out past one successive meridian after another westward to the Pacific. Its presidents from Jefferson, Polk, Lincoln, to the Roosevelts with the intervening Wilson, and the succeeding Truman and Johnson continued the vision and the thrust of its manifest destiny.

In American history, this intangible impulse appears indeed as the only plausible answer to the question: 'Why did the North fight the Civil War?' The