

SUMMARIES OF LECTURES in ECO 303Y1:
the Economic History of Modern Europe, to 1914
for the Academic Year: 2012 - 2013

Updated: Thursday, 21 March 2013

XXII: Week no. 22: Lecture Topic no. 27: 20 March 2013

Section VI: Russia, The Beginnings of Industrialization, 1815 - 1914:

D. Russian Banking and Finance: to 1914.

1. The Role of the State in the Russian Economy and in Banking Institutions:

a) Again the Russian state had long played a decisive role in establishing banks:

- i) beginning with the first state bank in 1754.
- ii) This and subsequent banks were essentially mortgage banks designed to assist the nobility and gentry in financing their estates.

b) Russia's defeat in the Crimean War of 1854-56: produced a final crisis (1856-57) that led to the collapse of all these banks.

2. Gosbank: the establishment of Imperial Russia's official state bank:

a) In 1862, these older banks were replaced by a new state bank: Gosbank (Government Bank),

- i) which was in fact a new department within the Ministry of Finance;
- ii) as such it represented a far more direct government intervention in the financial economy than found anywhere else in 19th-century Europe.

b) Gosbank began by acting as a regular commercial bank:

- i) i.e., a bank of deposit, transfer, lending, and discounting;
- ii) subsequently it established over 900 branches throughout Russia, while also sponsoring the creation of new joint-stock banks.
- iii) From the 1880s, it normally handled about 25% (or more) of total lending and discounting in Russia.

3. Gosbank and Russian monetary policy: the Gold Standard and gold ruble.

a) The chief importance of Gosbank lay in its monetary policies:

- i) in putting Russia on the international gold standard, in the years 1894 to 1897,
- ii) indeed as the last major country to join that international group.
- iii) That success was due to one man: Count Sergei Witte, Minister of Finance, who successfully converted Russia's previous purely fiduciary paper currency (no metallic backing) with a fully, 100% gold-backed paper ruble.

b) Its objective was to induce a much greater influx of foreign capital:

- i) by offering investors the right to repatriate both principal and investment earnings (interest and dividends) in gold -- i.e., in that rubles were convertible into fixed amounts of gold and thus freely exchangeable into any other gold-standard currency.
- ii) Previously investors faced the uncertainty of returns in unbacked paper rubles, whose values had fluctuated considerably on foreign exchange markets.

c) Many historians have criticized this gold ruble monetary policy on three major grounds.

- i) That it was unnecessary, since large amounts of foreign capital had flowed into Russia for over the ten previous years, since the mid-1880s
- ii) That it was far too costly: in terms of both
 - (1) high taxation, especially on the peasantry,
 - (2) and high interest rates to attract foreign gold-backed loans, both of which were used to build up the gold reserves of Gosbank:
 - (3) high taxes and high interest rates, the critics contend, suppressed internal demand
- iii) Requiring 100% gold backing was an absurdly strict and repressive condition:
 - (1) as was contended for France (when the Bank of France had 50% gold backing), that high gold reserve made both the supply of money and the supply of credit rigidly inelastic,
 - (2) thus curbing potential economic growth.

d) The responses to the critics: a justification of the gold ruble policy

- i) **For foreign investments:** the gold ruble policy clearly worked:
 - (1) from 1885 to 1897, annual foreign capital inflows had amounted to 43 million rubles = 0.5% of Net National Income;
 - (2) from 1897 to 1913: foreign capital inflows rose 4.4 fold: to an annual mean of 191 million gold rubles = 1.5% of Net National Income
- ii) **Taxation:** did it become too severe of a burden?
 - (1) While per capita taxes did rise, in nominal terms, from 5.41 rubles in 1885 to 11.79 rubles in 1910, those values do not take account of the inflation from 1895.
 - (2) Taxes, as a percent of net national income, remained unchanged throughout this period at a stable 13%, while taxes as a percent of gross industrial output fell by half: from 51.3% in 1885 to 25.5% in 1913.
- iii) **The interest rates:**
 - (1) While interest rates (central bank discount rates) rose from 6.10% in 1885-90 to a peak of 7.80% in 1895-1900 -- and well more than double those rates found in Berlin and Paris -- the rates then fell, once the gold ruble had proved successful: to a new low of 5.10% in 1908-12.
 - (2) At the same time, the gold reserves of Gosbank also fell, because those previously high levels were no longer needed to command confidence.
- iv) **The money supply:** did the gold standard policy make it too inelastic?
 - (1) The money supply: if M1, narrowly defined, is calculated to include not just notes and coins but also chequable current accounts in the banking system, the evidence supplied by Ian Drummond simply refutes

any arguments about an inelastic money supply:

- (2) there is no correlation between M1 and the gold reserves,
- (3) M1 rapidly expanded, greatly outpacing the growth of the gold reserves, and continued to grow, exponentially, when gold reserves fell after 1897.

c) **conclusions:** The simple fact is that Russian industrialization after 1885 was totally dependent on the influx of foreign capital.

5. Gosbank and the Private Banks of Imperial Russia

a) Gosbank's role in fostering the growth of private commercial joint-stock banks:

- i) chiefly in St. Petersburg and Moscow, supplying up to 25% of the capital for some of these new banks
- ii) and thus holding voting shares on their boards of directors

b) The Investment Banks: before 1905

- i) The chief agency for funnelling the influx of foreign capital were the investment banks, both domestic and foreign;
- ii) indeed most of the domestic Russian banks came to be taken over (bought up) by foreign banks and investors.
- iii) The Industrial Depression of 1900-06, the Russo-Japanese War and Russian Revolution of 1905:
 - (1) very harmful consequences for those foreign investors who had invested directly in Russian enterprises
 - (2) these events also forced the government to focus its attention on the discontented peasantry

c) The Role of the Investment Banks, 1906 - 1914:

- i) the government now left the key role of promoting industrialization to the Investment Banks, which led the great Industrial Boom of 1906-1913,
- ii) by which time almost half of Russian banks were foreign owned,
- iii) and so were most of the new heavy industries in Russia.

d) Imperialism from such foreign investments?

- i) Those circumstances had led Vladimir Lenin, the future Bolshevik leader, to publish his seminal book *Imperialism: the Highest Stage of Capitalism* in 1916.
- ii) The thesis in essence contended that the New Imperialism was ipso facto the export of capital;
- iii) and that such capital exports and consequent economic dominance of foreign lands was the mechanism by which western capitalist were seeking to avoid their ultimate fate:
 - (1) to avoid a continual fall in the rate of profit, which would lead to increased exploitation of the working classes, driving them to Revolution and the victory of Communism;
 - (2) and thus they sought to avoid this fate by exporting capital to extract higher rates of profits in less developed countries.
 - (3) This topic of course relates to this term's B List Topic on The Theory of Capitalist Imperialism

e) Why France was the largest foreign investor in Imperial Russia (to 1917):

- i) Finally, we noted that the largest single share of foreign capital came, unexpectedly, from France.
- ii) The reasons are political, as France sought to build up the Russian economy and military as a counterweight to their new enemy: Imperial Germany

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Section VI: Russia, The Beginnings of Industrialization, 1815 - 1914:

E. The Industrialization of Russia to 1914: Metallurgy, Petroleum, and Cartels:

1. A review of the role of the state in the economy of Imperial Russia: in agriculture, railways, and banking

2. The role of the state in foreign trade: the role of protective tariffs:

a) **A new feature to be observed now is commercial policy:** high tariffs, culminating with the Mendeleyev Tariff of 1891 ("Monster Tariff"),

b) **two roles of protective tariffs, with a greater importance than as a fiscal policy to raise revenues:**

- i) To encourage or force foreign firms to jump over the tariff barriers by establishing branch plants in Russia, to produce and sell their goods there, in the Russian market
- ii) To provide the foundations for and protection for state-sponsored industrial cartels: since, as we saw in Germany, cartels cannot be successful unless they curb foreign as well as domestic competition

3. The Metallurgical Industries: coal, iron, and steel

a) **the former supremacy of Russia in world iron production:**

- i) We recalled, from the study of the British Industrial Revolution, that in the 17th and in much of the 18th century, world leadership in iron-making was shared by Sweden and Russia (in the Ural Mountains region):
- ii) both of which had rich iron ores, ample timber and thus relatively cheap charcoal fuels, and abundant water-power, not to mention cheap labour.

b) **the Impact of the British Industrial Revolution:** when the Industrial Revolution allowed the new coal-based coke and steam technology to gain ascendancy, the Russian Urals industry declined.

c) **The new Russian metallurgical industries:** especially in Ukraine:

i) The new primary source of a new and rapidly growing metallurgical industry lay in Ukraine:

- ii) railways: made possible by the role of the St. Catherine's Railway(1886)
 - (1) in linking up the immense coal deposits of Lugansk, on the Donets, near its junction with the Don (flowing into the Sea of Azov)

(2) with equally immense and rich iron ore deposits of Krovoy Rog, on the Dneiper, and the Kerch Peninsula in Crimea.

iii) The whole region became the Russian Empire's equivalent of the German Ruhr valley.

iv) Of course this industrial success was fundamentally based on foreign capital: indeed, foreign capital was responsible for 85% of Ukraine's steel production, from the 1880s.

3. The Petroleum Industries:

a) The other major new industry was Petroleum:

i) based on the Trans Caspian Railway (1883) linking the oil fields of Baku, on the Caspian, with Batumi on the Black Sea, for oceanic transport;

ii) and of course also on foreign capital and protective tariffs (to keep out American oil).

b) Markets: both export and domestic demand:

i) Briefly, around 1900, Russia enjoyed world supremacy in exporting oil, but soon lost that to the U.S.

ii) For Russia in particular, the chief market and source of consumption of petroleum was not the automotive nor chemical industries, both of which later (post WWI) became paramount;

iii) but rather kerosene fuels, to provide lighting for peasant households, as was also true in China -- providing Standard Oil Company's major overseas market (US petroleum cartel: 'Oil for the Lamps of China').

4. Industrial Cartels:

a) **factors that promoted industrial cartels in Russia:** for much the same reason as in Germany:

i) **Direct foreign investment by large scale foreign firms:** who were themselves often members of industrial cartels.

ii) **Industrial financing by syndicates of investment banks,** as in Germany.

iii) **Advantage of being a late starter:** begin large scale with the most advanced industrial technology, to compete with other countries.

iv) **Government policy:**

(1) to promote large-scale industrial cartels, sustained by protective tariffs and sympathetic courts: (2) that was deemed the best policy to promote rapid industrialization in those sectors most likely to increase Russia's military power.

v) **scarcity of industrial labour:** another aspect of Gerschenkron's thesis

b) Chief Industrial Cartels in Imperial Russia:

- (1) Pradamet in iron and steel (1902) and
- (2) Produgol in coal (1906).

c) **Industrial Scale:**

- i) **As in Germany**, those cartelised industries were characterized by having very large scale.
- ii) **Over 40% of all Russian factories:** employed more than 1,000 workers each.

d) **Urban Industrialization:**

- i) had more than doubled between 1860 and 1913:

- (1) from 6.6% to 15.3% of the population of European Russia
- (2) but still it was only 15%.

- ii) The growth of an urban industrial labour force:

- (1) had similarly doubled, in fact doubled from the 1880s;
- (2) but again, it was still only 2.3% of the population of European Russia in 1914.