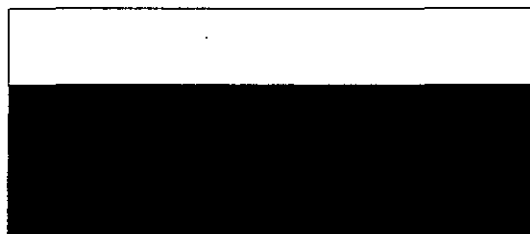


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The Creation of a Civil Economy in Russia

The Need for Mercantilism



Tony Baron & Robert McGarvey

An ERC Discussion Paper

*The Creation of a Civil Economy
in Russia
The Need for Mercantilism*

By

*Tony Baron and Robert McGarvey
With a*

Response

By Dr Chris Doyle

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The Authors

Summary

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If Russia is to avoid total economic collapse and political disintegration it needs to be appreciated that the mere importation of western style market institutions and legal systems is insufficient. The ethical foundation for the proper functioning of such institutions does not yet exist.

Russian reformers must realize that it will take many years of transition before the social legitimacy and the ethical foundation for a free market economy are generated. It is therefore mistaken and ultimately futile to attempt a leap from a command economy to a totally free market economy. Instead Russia should move through a managed economy stage.

ROBERT McGARVEY Bsc (Physics), Bsc (Petroleum Geology), Post Graduate Diploma International Relations and World Politics from the LSE. Mr. McGarvey, a Canadian, has 15 years experience in the international oil industry. He started his consulting career in Canada, joining Merlin Petroleum Consulting Ltd in 1976. In 1980 he was transferred to London to open and manage Merlin's UK office in London. After his appointment as Managing Director in 1984 Mr. McGarvey guided Merlin's entre into the global oil services market from its London base. Mr. McGarvey a member of the Economic Research Council since 1990, joined the executive committee of the ERC in 1992.

In its current state the appropriate model for Russia to imitate must surely be the mercantilist structures used by the Newly Industrializing Economies of Asia in the post war era, or Germany in the 19 century. The pursuit of modified mercantilist policies is much more likely to produce the social consensus that is vital for Russia to move towards a civil society than the present reform initiatives. Such policies would help re-establish the legitimacy of the Russian state and give the government effective means for revenue raising. It the same time they would help to build the ethical foundation for a market economy through widening the estate of ownership.

By far the greatest contribution the West can make to Russia's development along the road to liberal democracy and capitalism is to accept its need to pass through a period of mercantilism. Provided that the Russian reformers accept the need to go through the stages of capitalist development there is no reason why Russia, with its vast natural resources and highly educated population, cannot move relatively rapidly towards a fully functioning liberal capitalist democracy.

This paper, prepared for the Economic Research Council, is an application of various theoretical precepts developed in *CAPITALISM: The Continuing Revolution* a book, which *Baron* and *McGarvey* are presently co- writing.

The Creation of a Civil Economy in Russia The Need for Mercantilism

Russia today, after nearly two years of reform, is struggling desperately to avoid total economic collapse and political disintegration. Although President Yeltsin retains widespread popular support, as shown by the recent referendum result, there is a very substantial risk that growing poverty, corruption, organized crime and hyper inflation could trigger an anti-reformist backlash. There is increasing anxiety in the West that such a development, in turn, could derail the reform process and unravel all the progress which has been made in international relations since the Gorbachev era. The fear amongst Russian reformers and their Western sympathizers is that any deviation from the present radical reform agenda will open the door for the communist old guard to frustrate the movement toward democracy and capitalism. This paper contends that there is a greater risk to democracy and capitalism in forcing too great a pace of change on the Russian economy. A transitional stage, a period of 'managed capitalism' on the mercantilist model is needed, in order to build the infrastructure, both physical and ethical, for a functioning liberal, market driven, economy.

In the immediate aftermath of the collapse of communism Russian's embraced the 'idea' of western capitalism. Quite naturally they turned to the capitalist West for advice on transforming the command economy of the old Soviet into a functioning liberal capitalist economy. Western advisors identified several structural weaknesses in the command economy which needed to be addressed, if the transition to capitalism was to be effected quickly. A functioning capitalist economy needed price stability, currency convertibility, private property ownership, and most importantly, a legal system which enforced the laws of contract. Taking this on board the original Russian 'Plan 500' was radical. It envisioned a 500 day period of rapid institutional restructuring leading to a market economy. The plan involved converting the rouble to a hard currency, the immediate de-regulation of prices, a massive privatization programme, and a broad ranging deregulation on the movement of people, goods, and capital. However, the growing economic and social dislocation which accompanied the progressive implementation of the reforms was so great that it soon necessitated the modification of the plan.

"Mr. Gaidar is a competent economist but ... he should be carrying out his experiments somewhere on the moon, where there are no people."

Ruslan Khasbulatov

The reforms undertaken to date in Russia have had the effect of substantially dismantling the communist command economy. Unfortunately they have not, so far, delivered the promised liberal capitalist economy. Reformers have concentrated largely on institutional reforms, which, ironically, have had the effect of undermining confidence and stability. With the disintegration of the former, long-established economic, social and political structures and with the confusion over new legislation, crime has soared. The rapid rise in crime has been characterized by the growth of organized criminal groups, generally known as *the mafia*. Major Russian cities are divided territorially between mafia groups, with Moscow, for example, reportedly divided amongst twenty such criminal groups.

While the rise of such groups is clearly socially disruptive a far more serious threat to the success of the reform process in Russia is posed by the prevalence of corruption in central and local government bodies. It is reported, for example, that in 1992 \$ 2 billion simply vanished from the accounts of the foreign trade ministry. It is estimated that 90% of government officials engage in commercial work despite a presidential decree on 4 April, 1992 prohibiting such activity. The lack of respect for law and the all pervasive problem of corruption is perhaps best illustrated by the wide spread evasion of tax. It is reported that 40% of taxes are unpaid. The depth of the corruption in the taxation service was dramatically demonstrated in February when Vladimir Pankov, deputy head of the service, was arrested and charged with bribe taking.

The criminalization of Russia's banking system is yet another example of the crime wave sweeping the former Soviet Union. A new clearing system was established in 1992 which abolished the former system of direct clearing between banks. Criminalization of the system was immediate and massive. The Interior Ministry's Sixth Department, set up to deal with organized crime, estimates that 300 billion roubles was lost to organized crime in 1992. This overt criminal activity, combined with firms simply refusing to pay their bills (estimates of inter-enterprise debt vary between 11-13 trillion roubles in the first qtr. 1993), is threatening the stability of the monetary system.

This wide spread corruption and criminalization of Russia was clearly not foreseen by the Russia reformers and their Western advisors, but it clearly threatens the process of building a liberal capitalist democracy in Russia. In his prize winning essay, 'Eastern Europe's Need for a Civil Economy', Professor Richard Rose, director of the Centre for the Study of Public Policy, made an important contribution to the debate on Eastern European transformation by drawing attention to the fact that a flourishing private sector depends upon the law and order of a *Rechtsstaat* (a state based on right not might) and that the transformation of the ex-communist European societies, unlike China, is advancing on two fronts: a political shift from totalitarianism to democracy, and a shift from a centrally planned to a market economy.

THE MORAL FOUNDATION OF CIVIL SOCIETY

Much of the advice given to the Russian government by western economists does not appear to have fully comprehended the need to establish an ethical foundation for market institutions in a civil economy. To quote Rose: 'So accustomed are economists to operating within a framework of a lawful society where corporate and national income accounts both have integrity that they mistakenly assume that the collapse of a command economy automatically creates a civil economy.'

What is not appreciated by most western economists is that the market institutions and legal systems, so vital for a functioning capitalist economy are not, in themselves, sufficient. These institutions presuppose the existence of an ethical foundation in society to support them. A capitalist system can only function effectively if there are high degrees of individual self regulation and respect for institutional authority, amongst the vast majority of the citizenry. The ethical foundation, what Adam Smith referred to as the 'sense of propriety', relates to societies sense of justice, the degree of mutual respect and tolerance. It is these qualities which give substance to the legal system and provides the moral underpinning for open market institutions. Therefore simply setting arbitrary standards in law is insufficient. Laws lacking widespread respect and agreement will simply be ignored, which is precisely what is happening in Russia today.

The measures undertaken by the Russian reformers have had the effect of generating what Rose has described as an uncivil economy, one in which vast numbers of people simply ignore their legal obligations. The majority of Russians depend upon 'a mixture of legal, alegal and illegal economies' because the official economy does not provide sufficient income for everyday needs. Such an uncivil economy with its full complement of open criminality, corruption and other anti-social tendencies is undermining the stability and the legitimacy of the Russian state. The Russian economy today resembles, not so much an emerging liberal capitalist society, but a rerun, on a much larger scale, of the Weimar Republic of the interwar period in Germany. The growth of an immoral, uncivil economy is unfortunately precisely what the communist ideologues have always led the Russian people to believe 'capitalism' was all about.

"The economic situation is the biggest reason (for the huge rise in crime)... That and the collapse of ideals. The old ideals are gone - but there's no new morality".

*Lt Colonel Petrovich
(as reported in the London Evening Standard)*

The philosophical re-orientation which is occurring in Russia today is generating many random social forces, operating without aim or purpose or principle. Russia's growing anarchy is the human, political equivalent of a nuclear chain reaction. Russian society, like all societies, can be viewed as a moral reactor. Like the reactor walls, society must provide the degree of containment necessary for these vast forces to be directed toward productive and positive ends. In order to provide this containment society must maintain its moral foundation. Where this vital foundation fails completely there is the possibility that anarchic forces will break loose, unleashing the equivalent of a human Chernobyl, a 'moral meltdown' the consequences of which would be as horrific as those now being witnessed in Bosnia.

What, if anything, can be done? Rose argues that: "*A civil economy is a precondition for the success of the market ... To encourage the development of a civil economy, policy makers should avoid criminalizing economic activities by imposing taxes that its officials can not collect, and making expenditure commitments as if it could administer a tax system like Scandinavia.*" He further argues that ex-communist states should rely upon second best tax 'handles' such as a property tax and making social benefits dependent upon social insurance contributions.

While this prescription would undoubtedly be useful in helping create a civil economy it would prove insufficient in itself. As Rose himself argues European ex-communist societies are involved in a double revolution: a shift from totalitarianism to democracy as well as a shift from a command to a market economy. To build a 'Rechtsstaat' in Russia in which all laws, not just those of property, contract and taxation are respected, requires not just a change in fiscal rules but, by necessity, action to create the social and political consensus necessary to achieve a broad ranging support for the legal structures.

How can the ethical foundation for a civil, capitalist society be built? Hayek argued persuasively that a civil society is, in part, a function of private ownership. Hayek observed that where ownership is widespread and mutual it seems to build, in time, the value networks in society supportive of capitalism.

MERCANTILISM

Historically, it can be seen that as private ownership has become more broadly distributed in western societies, the ethical sensibilities and value systems supportive of capitalism have slowly and progressively matured. Indeed, the present stability and social legitimacy of western open market institutions lies in the ethical accountability of private ownership; the largely voluntary assumption by the majority of social responsibilities. Russia has started on the path of devolving private ownership and responsibility, but clearly ethical standards cannot be changed over night.

Re-establishing the moral authority of governing institutions is vital if the Russians are to consolidate the state politically, and lay the foundation, upon which, a market economy can prosper and grow. But how can this moral authority be established? It is not enough to simply identify the goal of a liberal capitalist democracy and expect that the population will accept any hardship the current reform process generates. For laws, or indeed any institutional authority, to be accepted they must enjoy social support; they must in other words accord with society's perception of what is 'just'. Furthermore it is necessary to understand that what is perceived to be 'just' at any given moment in history is established not only in relationship to an idealized vision of how society should be in the future, but also in relation to social values and power structures defined and legitimized in the past. Policy makers must accommodate political reality and distinguish between the ultimate destination itself (liberal capitalist society) and the means of achieving that end. If the institutions of government are to establish moral authority leaders must articulate the future, they must have a larger social vision. But if policy is to enjoy social legitimacy it must accommodate the reality of today and accord with societies prevailing sense of social justice¹. Therefore, as much as the Russian reformers may desire a quick move to a market driven capitalist economy they cannot escape the legacy of communism. Forced collectivization in the 1930's essentially concentrated all ownership (and therefore all power and responsibility) in the communist party. The structure of ownership in the communist command economy was, in this respect, quite similar to the feudal economy of medieval Christendom². Strictly speaking there was no generalized private ownership, or, by definition, legal markets in either system. Historically the transition from this pre-market stage to the more advanced market stages of capitalism necessitated a period of mercantilism.

¹ In Britain we have a recent example of this principle. The 'poll tax', although in principle extremely democratic, failed politically because it offended British society's prevailing sense of social justice, which could not accept that the 'poor' should pay the same as the 'rich', even for equal value.

² The medieval feudal economy in Europe was dominated by the Roman Church. In effect the local feudal nobility enjoyed a near monopoly of ownership, thereby dominating the market place. Prices in the feudal economy were not established in the market place through impartial supply and demand relationships, they were (like communist prices) controlled by central officials. In the feudal economy the Church controlled prices and market forces greatly through its Law of 'Just' Price and its condemnation of usury.

Ever since '*The Wealth of Nations*', Adam Smith's famous demolition of mercantilism, it has been seen by the vast majority of western economists as an outmoded system, used only by politicians, ignorant of economics, to justify their unwarranted interference in the economy. What is not well appreciated is that mercantilism played a very progressive early role in Western economic development and in one form or another will be necessary in the development of the Eastern economies as they re-enter the global economy after decades of communism.

Classical mercantilism, the set of economic practices which predominated in western Europe between the 16th and 18th centuries, played an important role in the transition from the command economies of feudal Europe to the relatively 'open', producer dominated, market economies which emerged in the late 18th and 19th centuries. Mercantilist policies, characterized by monopoly, protectionism, state regulation and import restrictions, were not simply designed to develop the local economy, but originated out of the 'harmony of interests' which formed between Princes, needing to expand revenues to help build the nation state, and rapidly rising commercial interests wishing to break down the restriction and particularism of the feudal economy. This tightly controlled system created great opportunities for the new breed of capitalists so long as they served, in the final tally, the larger political purposes of state building.

By the late 18th century, Adam Smith's critique of mercantilism was, of course, wholly appropriate. Mercantilist practices were restricting the natural development of open market economies in the West. Today, from the vantage point of the western economies, at least, mercantilism remains wholly inappropriate and retrogressive. However, it must be appreciated that all modern liberal economies have evolved to their present advanced state by way of a transitional mercantilist stage. The length of this transitional stage of economic development has varied, but has tended to become shorter as the global economy has become more sophisticated and interconnected. The early developing western economies needed several centuries of classical mercantilism, while later developing economies like Germany and Japan in the 19 century, adopting a neo-mercantilism, managed this stage in less than a century. Recently the Asian tigers have further modified mercantilism to their particular circumstances and reduced this transitional stage to a few decades or less.

Mercantilism allows the controlled growth of private ownership in a previously closed, pre-market or command economy. By encouraging the devolution of ownership in Russia, from the state to private individuals and firms, neo-mercantilist measures would encourage private enterprise and productivity,

while maintaining accountability. Furthermore, by widening the estate of ownership in Russian society, neo-mercantilism could help to encourage the growth of the value networks supportive of private property ownership and contract; necessary pre-conditions for liberal institutions and open markets to operate without wholesale criminalization.

Therefore, rather than attempting to leap to an advanced liberal market economy Russian reformers need to appreciate that it will take many years of transition before the social legitimacy and the ethical foundation for a free market economy are generated.

THE PATH TO RECOVERY

The Russian Federation, along with all the other former Soviet Republics, has a desperate need to re-establish the legitimacy of the state and its political institutions. Furthermore, (and unlike China) Russia has few people with the capability and experience of taking entrepreneurial risk within a legal framework. These twin problems can best be addressed by the adoption of modified mercantilist policies. Clearly free market institutions are the ultimate goal for Russian reformers. However, free markets should not be viewed simply as institutional phenomena which can be erected at will. Truly free markets are difficult to achieve. Even in the most mature economies of the West the social consensus for a free market in, for example, food does not exist, witness the Common Agricultural Policy. In its current state the appropriate transitional model for Russia to imitate must surely be the neo-mercantilist structure used by the Newly Industrializing Economies of Asia in the post war era, or Germany in the 19 Century.

Agricultural Reform

The need for a managed economy in Russia is perhaps best illustrated with reference to agriculture. At the most basic level the Russian government needs to ensure that the people are fed. It is well known that private food production in Russia is much more efficient than that achieved by the collective farms. It is also well known that the food distribution system is grossly inefficient and that much food rots or reaches the consumer in poor condition. Furthermore because of rampant inflation farmers are unwilling to sell their produce to the cities.

How can food production be increased, its distribution to the cities ensured, and private ownership encouraged? Here Russia can draw upon the success of US and Canadian Homesteading legislation, and the vital role homesteading played in establishing a civil society in North America. Russia's collective farms need to be privatized giving 'qualified' ownership to individual farmers, with full title to the land passing to them only after a period of years and presuming that they fulfil certain conditions. In particular, they could be required to cultivate the land and sell a proportion of their crops, subject to an absolute minimum, to official marketing boards at a regulated price. The application of a version of the homesteading principle could bring a number of benefits. Besides directly encouraging food production it would, by widening the estate of ownership in society and regulating that ownership to public purpose, help consolidate the necessary ethical underpinning for a capitalist system through encouraging the value systems in society which are a function of widespread ownership of property. Furthermore by limiting the dispersal of land to individuals homesteading in Russia would encourage cooperation, as it encouraged the 'barn raising' tradition in pioneer America.

Industrial Strategy

Russian reformers need to develop a coherent industrial strategy. If the Russians are to emerge from the pre-market economy, which communism re-created in Russian society, they should perhaps season their Harvard economics with a dash of Friedrich List, the great 19c German-American economist. List, the 'father' of German industrialization, felt that industrial development could only be accomplished in 19c Germany by the temporary expedient of tariff barriers to industries outside Germany, the abolition of internal barriers to trade and establishment of a national political structure. If the Russian's are to build their civilian industrial base they will have to adopt a similar strategy and industrialize behind tariffs and quotas so that their industries are not wiped out by international competition. Note the fate of east German industry following German reunification. In order to encourage enterprises to become more efficient, and ultimately internationally competitive, the phased elimination of the tariffs and quotas needs to be clearly laid out from the onset.

The most obvious candidates for early development are Russia's natural resources, oil and gas, diamonds, and other minerals, and its substantial scientific and technological expertise, illustrated by its space programme. Although lacking in other forms of capital Russia is relatively well endowed with human capital. The rapid development of these natural and human resources can only be achieved if the current very high levels of uncertainty in Russia are reduced. This

undoubtedly requires clear, consistent ground rules regarding, for example, ownership, taxation, and regulation. It further requires measures to increase the likelihood of profit so as to encourage the active participation of a population unused to taking entrepreneurial risk and the involvement of foreign capital, which has innumerable other investment possibilities in for example China. This can be achieved by the granting of fixed term licences (expiring after, possibly, 15 years) with foreign participation auctioned to the highest bidder. Such a system would allow foreign companies with their modern management techniques, their technology and their capital to be relatively safely introduced into the economy. They would also allow local expertise to be build up so that in time when the system opens up to competition domestic expertise is well placed to participate on a equal basis.

Monetary and Fiscal Reform

As crucial as it is for Russian reformers to develop an industrial strategy, by far the most important task is to establish a firm grip on monetary and fiscal policy. Failure to do so could result in the total collapse of the money economy. Inflation in the first quarter of this year was equivalent to an annual rate of over 1000%. The Central Bank is now preparing designs for 50,000 and 100,000 rouble notes and the rouble, once fixed at two to the US dollar is now trading in the range of 950 to the US dollar. Already barter accounts for about half of all trade between firms and the use of foreign currency is widespread. The authorities are anxious to prevent the dollarisation of the economy and a regulation was introduced in January attempting to ban the sale of domestically produced goods for anything other than roubles. Confidence in the rouble cannot, however, be ordered by dictat. For the internal purchasing power of the currency to be stabilised the explosive growth in the budget deficit needs to be contained and the Central Bank's practice of constantly creating credits to bail out loss making state enterprises must cease. The budget deficit, which amounted to about 650 billion roubles in 1992, looks like rising to 3.5 trillion this year.

The problem of instituting sound monetary policy in Russia is complicated by the fact that the Russian Central Bank is answerable to Parliament, not the President, and that its Chairman, Viktor Gerashchenko, is sympathetic to the old guard. President Yeltsin is known to want Gerashchenko to resign and perhaps, with his enhanced authority after the referendum, make Boris Fedorov, the reformist Deputy Prime Minister, the new Chairman. Under Gerashchenko the Central Bank has continued to issue new credits contrary to the Government's austerity programme. However, it would be wrong to blame Russian inflation solely on the Central Bank given the massive and expanding budget deficit.

Assuming that reformists do manage to gain control of the Central Bank, the question of how they should tackle the problem of inflation is perhaps best answered with reference to German history. In particular the success of Dr Hjalmar Schacht in introducing a new Rentenmark following the hyperinflation of 1923 is worthy of close examination. This new mark was supposedly backed by land and was accepted by the German population. The demand for Rentenmarks to rebuild real cash balances gave the Government a breathing space during which it was able to cover its expenditure with new issues of money while taking steps to restore budgetary balance through cutting spending and raising taxes. In Russia today inflation is nowhere near as high as in Germany in 1923 but the inconvenience of the current inflation rate is such that a credible monetary reform could result in a substantial increase in the demand for real cash balances. This would temporarily help to finance the Government's budget deficit. Given that one of the aims of the reforms in Russia is to privatise state holdings, a new rouble backed by land could be introduced giving individuals the right to convert roubles into land at a fixed price per hectare up to a certain amount per individual for a specified number of years.

However, for the government to be able to sustainably reduce its budget deficit, it must secure reliable sources of revenue. How can this be done when there is little personal income to tax and no established norms of civil responsibility? Rose clearly identified this problem and its solution in finding second best tax 'handles'. Fortunately mercantilism provides clear examples of how such tax handles can be found. Monarchs in the early state system imposed import duties and set about establishing various trading monopolies from which they could extract a guaranteed revenue flow or 'royalty'. The Russian government should sell trading licences giving firms initially well-protected markets for fixed terms. These enterprises having good, if heavily regulated, profits should then pay a 'royalty' for their privileges, thereby securing a revenue stream to the government. Non-payment of royalty and other taxes would result in the automatic loss of licence thereby discouraging tax evasion.

Labour Market Strategy

It is impossible to move from a military dominated command economy to a free market, civilian economy without causing massive upheaval in the labour market and widespread unemployment, as can be seen the former East Germany. However, unlike the fortunate East Germans, supported by massive transfers from western Germany, the Russians social safety net has to be constructed within the limits of domestic resources. The labour market needs to be managed through a difficult period of transition before it can safely be left to

function as a totally free market. It should be remembered that the UK experienced a number of years of labour direction immediately following the Second World War as the command economy formed for the prosecution of the war was slowly dismantled and transformed back to a civilian economy.

Russia is fortunate in having a large, well educated population, but lacks capital. Clearly Russia cannot afford to simply waste this human resource through unemployment. And, of course, for social stability large scale unemployment, particular among the former military, cannot be tolerated. The Russian transition requires, as with the UK after the War, a period of labour direction. The activities of individuals must be directed to socially useful ends, away from criminal activity. The physical capital such as roads, bridges, etc. required for the development of the economy needs to be acquired through the application of the labour and technical skills of the population. Equally the drastic need for housing needs to be met and such building activity would be highly labour intensive. But how can such activities be paid for? One way would be to require young people to participate in a programme of Community Service in return for which they would receive their keep and a small allowance. Community service, which in effect can be seen as a form of 'workfare', is likely to prove socially acceptable during this current period of crisis and dislocation.

The West's Contribution

By far the greatest contribution that the West can make to Russia's development along the road to liberal democracy and capitalism is to accept its need to pass through a period of mercantilism. The West needs to accept that Russian industries will have to be sheltered behind tariff and quota barriers for a prolonged period. However, to raise productivity in Russia and to bring it gradually into the orbit of the market economies, a programme for the phased reduction of these barriers to trade needs to be agreed at the outset. The West must also permit Russia access to its markets even though this will inevitably lead to some disruption in the western economies. In effect the special treatment afforded under GATT rules to the less developed economies need to be applied and extended in the case of Russia.

Provided that the Russian reformers accept the need to go through the stages of capitalist development there is no reason why Russia with its vast natural resources and highly educated population cannot move relatively rapidly towards a fully functioning liberal capitalist democracy.

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A Response by Dr Chris Doyle

In their article McGarvey and Baron (M-G) argue that a period of Mercantilism is necessary for the sustainability of the reform programme in Russia. M-G criticise the conventional viewpoint on reform in Russia, that marketisation ought to happen quickly. It is claimed that Mercantilism offers the virtues of gradualism, the ability for Russians to adjust to the ethical foundations of an economy dominated by private ownership and relational contracts.

Mercantilism is defined as having four components: (i) monopoly, (ii) protectionism, (iii) state regulation and (iv) import restrictions. These market impediments, if combined successfully, it is argued, would bring about a 'harmony of interest' as in western Europe between the 16th and 18th centuries. This would lead to accumulation and growth which would eventually result in their removal. In other words, Mercantilism assures growth behind barriers in the early stages of development, but to generate further growth barriers need to be removed to facilitate trade. If barriers are brought down immediately, as many interpret the present Russian reforms, this could be overwhelming and counter-productive.

In contemporary times South Korea and other Asian Tigers are illustrations of the success that can be achieved by careful construction of barriers. In the context of transition economies, such as Russia, the idea is to build barriers to 'rejuvenate industry' as opposed to the protection of infant industries. For small economies embarking on a path towards manufacturing there seems much more sense in pursuing protectionism. However, it is by no means clear that the same mechanisms could work in a large, closed economy like Russia.

Although Russia has considerable resources of primary products, its problems lie in low productivity capital in the manufacturing sector and in a woefully inadequate tertiary or services sector. Protectionism discipline protected monopolies would be small. B-M argue that foreign joint-ownership would play an important role. It is likely, however, that foreign capital will focus largely on tradeables, predominantly in the primary sector. This is not the way in which western Europe or the Asian Tigers developed.

The economic situation is unique and there do not exist any obvious miracle cures. This is widely acknowledged. Where disagreement prevades is in terms of policy implementation. As last the western donor countries are no longer convinced by simplistic targeting favoured by the IMF, but as yet there is no consensus on the best way forward. In many respects the outcome will be a combination of economic policies that have been applied elsewhere in the past.

Dr Chris Doyle
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21 May 1993

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