Part I

Rationale for the State’s Expansion

Why should a private enterprise economy be subjected to any kind of government intervention and not be left entirely to the guidance of the “invisible hand” of the market? The answers to this often-repeated question have varied enormously through time under the impact of intertwined economic, social, and political considerations and of power relations within the society. Modern conservative politicians, and certain economists, contend that the more limited the economic role of the state, the better off the economy and the population at large. Other economists dismiss this contention and its theoretical underpinnings as unrealistic (as we shall see in Part II). These economists point out that the market cannot perform all the socially necessary economic functions – moreover, that it could not consistently discharge all of them efficiently. As a matter of fact, the state’s (i.e., the government’s) interventions in the economy have developed historically in a number of ways that could be grouped into the following basic categories: legal and regulatory, allocative, growth-oriented and/or stabilizatory, income distributive.

Building on the foundation of property laws, the first category of activities has consisted of determining the market’s legal structure and regulating its processes involving coalitions and bargaining among consumers and firms. As Professor Milton Friedman, an ardent defender of individuals’ freedom to choose, has pointed out (in Capitalism and Freedom), government is essential for achieving something that the market cannot do for itself, namely to act both as “a forum for determining the rules of the game” and as “an umpire to interpret and enforce the rules decided on.”

Other government activities have arisen from the necessity of supplying various collective types of goods and services – referred to as social goods in contrast with private goods – which the market fails to properly price and provide either entirely or in an efficient way. This may concern the handling and impact of “externalities” (namely, pollution’s neighborhood effects) or the provision, say, of spacecrafts and military hardware – that is, goods whose benefits are not limited to the one consumer who purchases the good, as is the case for private goods. (But the production of certain social goods could
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of course be carried out directly by state-owned enterprises or by private ones selling their products to the state.)

It is in particular the growth-oriented and income-distributive groups of state interventions in the economy that have brought forth the increased disagreements of modern conservatism (discussed in Part II). This group of activities – aiming to affect notably aggregate demand, employment, output levels, and prices – has involved recourse to a variety of measures, including deficit spending (often leading to vast expansions of state expenditures at given historical junctures), purchases of failing private firms, and a host of subsidies, grants, and joint (public–private) partnerships. Finally, the income-distributive group of state interventions has embraced activities involving adjustments and “corrections” of the market-conditioned distribution of income and wealth, aiming to help the unemployed, the aged, the disabled, and the disadvantaged in general, and thus bring the income distribution in line with society’s apparent current ideas about ethical standards and a “fair” social distribution.

The ways in which any and all of these functions have been interpreted and discharged by states – whether from deep-rooted causes or under the influence of passing circumstance – have of course varied over time and have called forth reinterpretations, criticisms, corrections, and even policy reversals. As I indicated in the Preface, in this work I am drawing the reader’s attention mainly to certain states’ approaches to state ownership and to income transfers for social welfare. In Western Europe and in the United States, the latter activities have tended to grow concurrently (particularly in the interwar period and after World War II) and have eventually called forth powerful reactions against their growth, as we shall see.

In Chapter I I point out the ways in which state ownership has developed in Britain, in France, and then in divided Germany during the so-called epoch of “merchant capitalism,” that is, from the seventeenth through the eighteenth century, under the predominant economic philosophy of mercantilism. I then examine the special conditions supporting the further growth of this kind of ownership in the nineteenth century and up to World War I – that is, during the early years of “industrial capitalism” in Great Britain and France, and afterward during the period of the spread of industrialization, notably to both the United States and Germany under the guidance of mixed mercantilist–liberal approaches. I then focus on the creation in World War I of the first “command economy.” The command economy is up to a point the model implemented, with various adjustments, first by the Soviet Union, on the basis of a centrally directed, fully nationalized economy, and then by the Nazis, on the basis of a vast and thorough network of regulations and controls of an economy predicated on private ownership. Afterward, I draw attention to the eventual expansion of the role of the state, state ownership,
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and welfare measures, first in the United States during the Great Depression and then in Western Europe after World War II until the 1980s, in the form of (so-called) nationalization and the creation of “welfare” states.

Again, as I indicated in the Preface, a number of post–World War II economic changes in the West reflect in a delayed, ambiguous, and remote fashion the trajectory of the Soviet Union’s drives for expanding state ownership and for directing its economic processes in a “planned” style. In Chapter 2, I sketch only the ways in which the communist party-state was put together on the ruins of the tsarist empire and on the latter’s economic legacy. I indicate how, under the guidance of the Marxian theory as interpreted by Lenin, the new state transformed the economy, modified its structure, expanded state ownership, and attempted (ineffectually) to direct all its input–output operations. After examining as well the nature and extent of the Soviet income transfers for its social “safety net,” I show that the sought-after complete centralization of the hierarchically structured Soviet economy could not fend off the quasi-market relations seeping into its state complex and distorting its central commands. Nor could it eliminate the deformed market relations surrounding it. I then present in broad outline the various historical phases of the Soviet regime and the nature and scope of the various reforms attempted there and in its satellites, showing their eventual impact on the collapse of the Soviet party-state. It is in Parts II and III that I consider the problems of the transition from that system to a capitalist one.
1 Public Ownership and Welfare

1.1. Mercantilism and State Ownership

The emerging and then consolidating European monarchic states of the seventeenth and eighteenth centuries inherited from the powerful examples of the medieval city-states such as Milan, Florence, Bologna, Genoa, and Venice a tradition of continuous interventions of the central power in the economic and social life of their communities, along with a strong impulse toward an incessant warfare of competition and aggression. In many respects some of these policies, which began to assert themselves forcefully also in England and France from the sixteenth century on and which came to be known as “mercantilist policies,” were actually extensions to the limits of the newly developing monarchical states of the traditional preoccupations and practices of the late Middle Ages. The modern states shaped themselves into strong and wealthy economic bodies by means of both internal and external conflicts. The internal conflicts pitted the central state power against the church, the nobility, the medieval parliaments, the districts, and the towns in a vast attempt to transform and reorganize society’s economic and social structures. The external ones involved the newly rising states seeking a dominant place among the European nations and in trade (which henceforth included America and India). State making and state power were thus intertwined. The essential means of power, wealth, was increasingly viewed as indispensable for security, aggression, and eventual conquest. States sought to attain wealth by avoiding the export of bullion (gold and silver) and by securing a favorable balance of trade. The latter was achievable first via the subsidization and strict regulation of production (in England with regard primarily to manufacturing, but also up to a point to agriculture, along with the management of shipping); second, via the restraint of imports through high duties and, if necessary, through absolute import prohibitions and the encouragement of exports using drawbacks, bounties, treaties of commerce, and the establishment of colonies. It was implicitly assumed that the entire country should identify its production with exports and its consumption with imports and,
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like a provident individual household, should avoid consuming more than it produced by its export earnings.²

In Britain, during the reign of Queen Elizabeth, as well as of James I and Charles I, the Crown tried to obtain an interest in every industry. Moreover, the Crown exercised a considerable royal prerogative in granting patents for carrying out highly remunerative operations in a wide variety of industrial fields, including the manufacture of saltpeter and gunpowder, alum, and soap.³ The attacks of Elizabeth’s sailors and privateers against the ships and colonies of Philip II of Spain were simultaneously a religious, a nationalist, and a profitable mercantile enterprise. The power of the country was heavily dependent upon shipping. The policy of encouraging native shipping as a means of bringing in wealth, which had engaged British attention since the time of Richard II, was embodied in very strict regulations by the Rump Parliament. Parliament promulgated these rules not only to encourage English commerce, but also to strike a blow against prosperous Holland.⁴ Foreign trade was viewed as subservient to state power – that is, meant to bring in the wealth needed for the strength and security of the realm. However, the trade operations themselves were let out to chartered and regulated companies (the East India Company, the Levant Company, the Eastland and the Muscovy [since 1698] Companies), all operated entirely by London merchants. It was in the financial district of the City of London, in its money market, its privately run Bank of England, and the East India Company, that the country’s economic power was concentrated. The weight of state-owned assets was limited. The Crown directly owned only the army and naval establishments, armories, military ships and dockyards, public buildings, the mint, and the post office (since the reign of Charles I). The Parliament was the “authorizer and constitutary” of canal companies and turnpike trusts.⁵

It was rather in the France of Louis XIV that the idea of vesting enormous economic powers in the state and an absolute monarch received its fullest application during the period under review. It was in France that the so-called mercantilist concepts were accepted as axioms. It was there that the following propositions were viewed as compelling: the prosperity of a state can be achieved only at the expense of its neighbors; bullion must be attracted into the country and prevented from getting out; and a nation must crush its enemies in order to achieve economic supremacy. The powers of the Crown to direct the economy, to control and support industry and mining, and to regulate the country’s commerce were far larger in France than they had ever been in Great Britain. The French king had control of saltpeter and gunpowder manufacture and the right to administer all defense industries, which became a vast royal enterprise. (Persons making arms or ammunition without royal approval were considered criminals punishable by heavy fines or death.) The country recognized the Crown’s ownership rights over all subterranean
wealth; over a share in the revenues from mining and metallurgy; over the disposal of certain national products (in particular, ores and mineral resources); over salt production, which yielded great financial returns to the royal treasury; and over the granting of monopoly rights to certain persons in various branches of manufacturing. Further, the Crown had the power to foster new arts and crafts and manufactures in any and all fields. Not one manufacturing branch or foreign trade operation escaped the king’s intervention and exigent protection. The apotheosis of French economic statism was reached in the seventeenth century under the rigid mercantilist administration of Jean Baptiste Colbert (1619–1683), King Louis XIV’s subservient minister. Following the royal tradition already established in the sixteenth century, Colbert held that France could achieve enormous riches if it were to produce goods of the highest quality in profusion and if it were to secure their transport and delivery abroad by its own means. At the height (1664–1669) of his career, Colbert established and rigidly controlled numerous royal manufacturing facilities – true state enterprises – for the production of fine tapestry, soda and coal tar, thread and cloth, dyes, leather goods, porcelain, and soap, as well as cannons and anchors. In addition, he extended subsidies, loans without interest, and direct and indirect bounties to various industries – in particular, to encourage the production of iron, coal, and fabrics of all kinds.6

Colbert’s legacy of exacting regulations concerning industrial production and trade were not without perspicacious critics. Among the latter, Pierre de Boisguilbert asserted (in his works of 1695 and 1707) that wealth depended neither upon the regulatory minutiae of manufacturing and commerce nor upon the overvaluation of precious metals, but rather on a “natural harmony” of industry, the supply of necessities, and the abolition of export duties, particularly on grain. Richard Cantillon, in his famous essay of 1755 on the nature of commerce, pointed out that as the supply of bullion increases in a country, prices go up, which discourages the foreign buyer, thus leading to an unfavorable balance of trade; but then as bullion declines, prices go down, and the process starts all over again. It was toward the middle of the eighteenth century that the revolt against Colbertism reached its peak (particularly under the impulse of the new Physiocratic economic school). However, while the perpetual Colbertian hindrances did call forth seminal ideas from the opposition, the latter remained for a long time ineffectual. In practice, Colbert’s regulations not only continued in force; they were even reinforced by further regulations.7

Meanwhile, with diverse adjustments and national adaptations, mercantilist ideas continued a triumphal march into Prussia (and afterward even into far-off Russia). A specific German derivative of mercantilism known as “cameralism” (from the word camera, designating the place in which the royal
income was stored) was an all-encompassing theory in which any problems of internal or external security resolved themselves primarily into the question of the princely revenues. Originally focused on efficient administration, specifically on the rules and practices of domanial and royal administration, cameralism eventually expanded to include broader economic issues and, in particular, finance problems. In this larger framework it envisaged managing a country’s resources in a way that would yield the most for the absolute monarchic ruler, in order to enable him to fulfill his duties, increase his power, and pursue his interests (allegedly coinciding with the interests of a prosperous population). In time, cameralism became the discipline used for training officials in handling the various economic problems that beset the German states from the sixteenth to the nineteenth century. Theories on tariffs and taxes, allegedly the best guarantors of wealth, on the promotion of industry and trade, as well as on the sources of international rivalry and differences in development, figured prominently in this broadly defined doctrine. From 1729 on, the study of cameralism developed in so many directions that it finally had to be divided into three disciplines – introduction to economics, policy sciences, and cameralist sciences – a division that subsisted for a long time in Germany’s universities.

The promotion by the state of industrial enterprises, even those whose ownership and direct use often belonged to the fiscal authorities, did rely on the advice and help of commercial firms. Such firms were eventually entrusted with the management of some of these enterprises, particularly those concerned with munitions, metals, cutlery, and sugar refining. Frederick the Great (1740–1786) contributed appreciably to pioneering investments in a number of crucial state-initiated enterprises, including the Silesian Malpane ironworks, endowed with the first blast furnace on German soil; the Berlin iron foundry, in which the entire Berlin manufacturing industry had its origins; and the manufacture of silk in Krefeld, the weaving industry in Eberfeld and Barmen, and the linen industry in Bielefeld. In regard to maritime trade, Frederick established a joint-stock company (the Overseas Trading Corporation) in which he held the lion’s share and to which he granted numerous privileges – including the monopoly on buying and selling wax and salt. Before as well as after Germany’s unification, Prussia became the most important German industrial state, whose manufacturing regions (Silesia, Westphalia, and the Rhineland) eventually dominated the German economy. As Clive Trebilcock has pointed out, the interest of the state, however narrowly defined it might have been, did introduce new technologies and achieved significant results through their development. The Prussian war-related industries outlived other types of “protofactories” and thus, from a developmental point of view, provided a useful apprenticeship in industrial affairs for the Prussian state in a number of strategic industries. According to Albion
W. Small, the author of a detailed work entitled *The Cameralists*, from the cameralist point of view “the state was a magnified family with a big farm as its property” whose citizens “may, can, and should exist only in function of the state.”

At the close of “the epoch of merchant capitalism” in Western Europe, many of the mercantilist emphases – on comprehensive economic regulations, the forceful determination of the direction of industrial development, state ownership of mines and factors of production, state financing of manufacturing enterprises, and elaborate state controls on trade – started to be increasingly questioned. Here and there they eventually fell into disuse, notably in rapidly developing Great Britain. But they continued to play a critical role in other countries, where they were viewed as the necessary state instruments for changing the economic structure of economically lagging states, accelerating their industrialization and helping them to “catch up” with Great Britain.

1.2. Mercantilist–Liberal Mixtures and Industrialism

From the late eighteenth century through the nineteenth century the critique of mercantilism became insistent, though it was still not necessarily readily accepted and applied. The leader of the Physiocrats, François Quesnay, and his followers asserted that the role of the government was to protect “life, liberty, and property,” while production and trade should be left alone to be pursued freely. Hence their famous motto: laissez faire, laissez passer. While the mercantilists viewed as indivisible the ideas of state unification and state power, the Physiocrats separated the two. On the one hand, they were in favor of national unification in all respects, while on the other hand they were indifferent to “considerations of power.” Concerning the ends, mercantilism had been preoccupied with wealth as a basis of state power; physiocracy regarded laissez-faire as valuable to the individual and, therefore, desirable on that account.

The classic critique of mercantilism and state interventions in the economy, along with the most cogent case for free trade, was devised by Adam Smith in the late eighteenth century, in the increasingly industrializing Great Britain. In his well known and widely influential work, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Smith opposed a radically new approach to the old mercantilist ideas about the importance of protectionism for ensuring a favorable balance of trade, as well as mercantilism’s emphasis on domestic manufacturing to secure the state’s wealth and power. Smith stressed instead that consumption constituted “the sole end and purpose of all production” and that the interest of the producer ought to be attended to “only so far as it may be necessary for promoting that of the consumer.”
the mercantilist system, he noted, the interest of the consumer was “‘almost constantly sacrificed to that of the producer’” – and with regard to the management of colonies, he added, the interests of the home-consumer had been sacrificed to those of the producer with even a more “‘extravagant profusion’” than in all other commercial regulations. While, as we shall see later, from the early to the late nineteenth century Smith’s liberal critiques greatly influenced British economic thought and policies, in most other developing countries, including the United States, their practical impact remained for a long time marginal.

Yet the processes of industrialization that had begun in Great Britain on the basis of limited notions of science and engineering grew and spread in depth through increasing applications of sciences to production. This was the case in Britain itself, as well as in its former colony, the United States (particularly from the middle decades of the nineteenth century on); eventually, it was also the case in the Western European countries. In the early nineteenth century, the main characteristic of industrialization was expansion in the use of the machine into a limited number of industrial branches. In the second half of the century, accelerated industrialization produced not only diversified uses of new and increasingly complex machines in numerous industries, but also a vigorous expansion of science-based technologies, new industrial methods, and new products. In its earlier phases in Britain (from the mid-eighteenth century on), industrialization had involved empirical breakthroughs affecting textile machinery, textile chemistry, iron making, and coal mining. Up to around the 1830s, textiles in fact remained the undisputed leading industrial sector. A decade later – when Great Britain became the recognized “workshop of the world” – machine tools speeded up and standardized the output of looms, spinning machinery, steam engines, and other critical equipment. Simultaneously, the development of railroads pushed many-sided metallurgical industries and the new, science-based industries to the forefront in the newly industrializing countries.

Until the early nineteenth century, the British “mercantilist panoply” (as Sidney Checkland has called it) had been an extensive one. After the American colonies broke away from Britain and after the defeat of France at the end of the Napoleonic Wars, much of the scope of the laws that had been formulated in regard to British shipping and British imports from France fell into disuse. As industry increased in wealth, and eventually in political power, the Corn Laws were repealed (in 1846), thus eliminating the barrier to a general extension of trade and giving the great factory towns the advantage of a cheaper food supply. The obsolete Navigation Laws were repealed (in 1849), and various other measures (in 1853 and 1860) made free trade a reality in the full sense of the term at least until the 1870s. Yet, late in the Victorian days, as trade patterns started to change, the British suffered with
increasing discomfort the forceful competition resulting from the rapid and manifold industrialization of numerous developing countries, above all the United States and Germany. It was then England’s turn to wonder what measures might be necessary to defend its markets and avoid lagging behind the advancing United States and Germany.\textsuperscript{15}

Within its liberal, nonmercantilist framework, however, direct ownership by the British central government remained confined to defense establishments, the post office (which from 1912 on had an effective monopoly over the telephone system), and the telegraph (which had been added to the public sector in 1869). In addition, the government acquired a majority of shares in the Suez Canal Company (in 1875) and the Anglo-Persian Oil Company (in 1914). However, while at the central level the basic idea of state ownership was acceptable when a clear national interest was at stake, at the local level, communal interests drove in other directions. They pushed toward the expansion of municipal responsibilities and ownership in many new fields. From the 1890s on, after various battles with private companies, the municipalities acquired the right to go into business to provide not only water supply and sanitation, but also various new services, notably gas, electricity, and the tramways.\textsuperscript{16}

Meantime, the evolution of the former British colony, the United States, as well as the main European countries, paralleled only in some respects the British developments. In principle, it was thought that in the newly independent United States, the federal government would play only a minor role in relation to the states and local governments. For a long time it was also assumed that in contrast with experiences elsewhere, government ownership and operation of business-type activities would not play “a major role in the American economy.”\textsuperscript{17} But these contentions depend on how one chooses to interpret the terms \textit{business-type activities} and \textit{major role}. Laissez-faire doctrines (which as I recalled imply free trade and therefore only minor state interventions, along with close attention primarily to the needs of the consumer rather than those of the producer), while widely accepted in principle, particularly during the last quarter of the nineteenth century, had only a rather limited impact on government policies. Certain authors (Thomas K. McGraw, for instance) have pointed out that in the promotion of selected industries, the subsidization of exports, the limitation of imports, and the maintenance of an overall favorable balance of trade, U.S. policies actually paralleled certain forms of mercantilism dominant in the preceding centuries in Europe, though a coordinated industrial policy “has always been a hard sell in the United States.”\textsuperscript{18} From around 1816 to the onset of World War I, tariffs played their usual role in protecting and promoting U.S. domestic production. Behind its walls, many U.S. industries secured a domestic market free of foreign competition, under the pretexts of sheltering “infant industries,” pro-