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‘Financing industrialisation in Russia and Germany’

A large literature debates what system best promotes the accumulation and allocation of capital, especially in countries that industrialized relatively late and where capital market imperfections may be especially severe. Russia and Germany serve as the classic cases to argue that developing economies may successfully employ unusual strategies to promote industrialization, for example an outsized role for banks or state intervention. Law and finance analysis, moreover, attributes financial system differences to variation in legal system design. Such assertions, however, have relied largely on anecdotal evidence, country-level aggregates, or small collections of firms. New research into Germany and Russia has reshaped thinking about these two cases individually, but we still lack rigorous comparative analysis.

We therefore present new evidence directly comparing Russian and German corporate performance and financial strategies based on firm-level microdata from Russian and German sources around turn of the twentieth century and compare key stipulations of corporate law and their implementation. Contrary to the standard “economic backwardness” and “law and finance” literatures we argue that corporations in both countries used similar strategies to finance operations and expansion but that tight entry restrictions fundamentally distorted Russian industrial corporations.

For Germany we analyze a panel of more than 300 joint-stock corporations (Aktiengesellschaften) from 1895-1912, with very detailed information on location, year, industry, bank interlocks, financial statements--balance sheets and income statements – as well as stock exchange listings and share prices. The Russian data consists of balance sheets (share capital, assets, liabilities), income statements, and dividends for every corporation (roughly 1,000) in the Russian Empire from 1899 to 1914. The dataset is matched to the Ruscorp Database, which provides additional information collected from corporate charters, including some governance provisions, a proxy for whether the company is widely-held, and information on any restrictions on raising capital; and is also matched to the St. Petersburg Stock Exchange Project database, which provides monthly securities prices for all corporations listed on the St. Petersburg Stock Exchange. The Russian data are less detailed than the German corporation data, though the data still permit key comparisons.

We find that both Germany and Russia operated systems fundamentally built on principles of finance capitalism. In both countries, large companies took advantage of joint-stock incorporation to expand operations and ensure survival, partly by using outside financing in the form of bank debt, bonds and equity shares. Furthermore, equity and bonds in both countries traded on freely accessible stock exchanges in major cities. However, as theorized in the more recent strands of financial development literature, legal and institutional idiosyncrasies between the two contexts yielded key differences between their corporate populations. Fundamentally, we argue that tight restriction on incorporation in Russia hampered firms’ access to capital and impeded financial development and industrial growth compared to Germany. The Russian corporations that did form did not seem to be fundamentally primitive or purely rent-seeking, suggesting that restrictive chartering regulations prevented Russia from achieving a fully-functioning system of finance capitalism.