

I. (45%) Short Descriptions: Answer 15 of 18 (3% each). In two to three articulate sentences each, explain each of the following, along with their importance, context, or relevance.

- 1) **Bolshevik Revolution.** *In November, 1917, Lenin led the Bolsheviks in an attack on the Czar's former winter palace in Petrograd (St. Petersburg, later called Leningrad), and overthrew the provisional labor government of Alexander Kerensky. This began a civil war in Russia that led to the founding of the Union of Soviet Socialist Republics (USSR).*
- 2) **Basic Organization of Associated Labor.** *In Yugoslavia under Tito in 1965, the government created the BOAL as the essential organization of the labor-managed economy. BOALs organized among themselves to run most Yugoslav firms, and shared their profits among their members.*
- 3) **Cultural Revolution.** *The period in China from 1965-76 in which Chairman Mao Zedong organized young people into groups of "Red Guards" to attack any opponent of Mao, real or imagined, and destroy the "four olds." China became extremely conformist, millions were attacked and many killed, schools were shut down, and the economy stagnated until Mao died.*
- 4) **Great Leap Forward.** *A movement launched by Chairman Mao to go beyond Soviet methods and push China rapidly into the industrial age, with backyard iron smelters, huge rural communes with communal kitchens, extraction of the agricultural surplus for urban industry, and a belief that rapid change was possible through new ideas and the application of immense amounts of labor. The policies were very misguided, and the leadership was kept misinformed. The result was a catastrophic famine, and Mao stepped back from direct leadership in the early 1960s.*
- 5) **Household Responsibility System.** *The major rural reform after Deng Xiaoping became paramount leader of China, in which rural areas were effectively decollectivized and land was allocated to families for a fix quota or rent. Farmers had much more control over what and how they produced and they could sell any surplus at higher market prices. This led to a rapid increase in productivity.*
- 6) **Material Balances Planning.** *This is a quantity-based method of allocating resources and determining the inputs and outputs of different sectors of economy necessary to produce a certain set of final goods. It is based on Leontief's input-output analysis, this became an essential component of Soviet planning to replace market coordination.*
- 7) **Monobank.** *In the classical socialist economy, all banking and finance was monopolized by the state, and the state's bank became a tool of the state to marshal savings for investment in heavy industry and to control firm production by checking all purchases against the plan.*
- 8) **New Economic Mechanism.** *A Hungarian reform from 1968-73 under Janos Kadar that attempted to introduce economic reforms such as indicative planning, a limited market, a profit motive for the state firm, and some foreign trade, without political reforms, decentralization, labor management, or anything that would antagonize the Soviets. It was not very successful, and would later be followed by a new policy, "Reform of Reform."*
- 9) **Perestroika.** *This was General Secretary Mikhail Gorbachev's over-optimistic policy of restructuring the Soviet economy in the late 1980s. It failed for many reasons, but mostly because it effectively dismantled key elements of the centrally planned economy without creating a real alternative to it.*
- 10) **Prague Spring.** *Events in Czechoslovakia in 1968 that were led, at least in part, by Alexander Dubcek. Workers were allowed to take control of their unions and manage their firms through workers councils, the government allowed free speech and a free press, foreign trade reforms were enacted, and the result was an invasion by the Warsaw Pact. The result was the Brezhnev Doctrine.*

- 11) **Soft Budget Constraint.** *This refers to Kornai's argument that state-owned firms are inefficient because they know that they will not be shut down or punished when unprofitable. Because planners know prices and targets are arbitrary, they cannot use profits to judge firm efficiency, and so managers are able to negotiate with planners. This undermines their incentive to carefully manage costs and boost revenues.*
- 12) **Socialist Market Economy.** *The goal announced in 1992 by the Chinese Communist Party, which was a major ideological breakthrough because the CCP in essence renounced its goals of eventually returning to classical socialism in order to create communism. Practically, however, it was not clear what this meant, other than the creation of a market economy with the CCP in unchallenged political control.*
- 13) **Solidarity.** *An independent union formed in the 1980 uprising at Lenin Steelyard in Gdansk, Poland, and led by Lech Walesa. It would be recognized by the government and negotiated with, then outlawed, and then would re-emerge after 1988 as Poland's first post-socialist government.*
- 14) **Township and Village Enterprises.** *Rural firms in China that were at least nominally owned by local governments. In the early 1980s the government would allow them greater freedoms over what and how they produced in an effort to employ some of China's rural surplus labor, and the result would be rapid growth, productivity improvements, investment, and exports.*
- 15) **Two-tier Pricing.** *The method China used to "grow out of the plan." First farmers and then state firms were expected to produce their planned quota at the state price, but any production surplus could be sold at higher market or above-quota prices without the quota being ratcheted up. While it offered opportunities for corruption, it also encouraged rapid growth and competition, and when the plan was eventually dismantled it had become largely irrelevant.*
- 16) **Uskorenye.** *A policy of acceleration beginning in 1986, during Soviet Union's 12th FYP under Gorbachev. It called for retooling rather than expansion, better quality control, an attack on alcoholism, and attack on the underground economy, and an effort to unleash the "human factor" through Glasnost (Openness). It failed for a variety of reasons, including a "cavalier inconsistency," bottleneck in machine-building, conflicts with quality control, falling government revenues, and Chernobyl.*
- 17) **Velvet Revolution.** *Peaceful demonstrations in Czechoslovakia in the Fall of 1989 that led to the bloodless overthrow of the communist government. This was helped along by Gorbachev ending the Brezhnev Doctrine. Free elections were held, and the dissident Vaclav Havel became its first post-socialist president.*
- 18) **Visible Hand.** *In Yugoslavia after Tito's break with Stalin, this was the first move towards market socialism in 1951. Political power was decentralized to the Republics and to workers councils, collectivization was reversed, markets were encouraged, enterprises could set their own targets, and the role of central planning and administrative pricing was severely limited.*

II. (55%) Essays: Answer the following three question topics, each with a clear and cogent essay that demonstrates a detailed understanding of the course material.

(20%) What is the fundamental condition that defines whether an economy is socialist, according to Janos Kornai? What are Kornai's five steps of the classical socialist economy, and how do they fit together as a system? Explain. What institutions and characteristics are necessary components of this type of economy, according to his model, and why? How does his model explain the shortage economy? What is the Fel'dman model, and how does its explanation of the shortage economy compare with Kornai's?

Janos Kornai argued that the classical socialist economy could be described in five blocks, in order of causality: power, property, coordination, behavior, and phenomena. The essential element is the unchallenged power of a Marxist-Leninist communist party, which believes itself to be the vanguard of the revolution based on a true understanding of history and the representative of the dictatorship of the proletariat. To carry out its promise of eliminating an inherently-exploitative capitalist system, the party uses its power and its interpenetration of the state to force a predominance of state ownership over the means of production. Once state ownership of property predominates, the state is forced to use bureaucratic means such as directive planning and administrative pricing to coordinate the allocation of resources to production and the distribution of goods. This then results in peculiar incentives (e.g., the soft budget constraint, investment hunger, tonnenideologie) and behaviors (e.g., hoarding, plan negotiation) by the state's agents, its firm managers, workers, and consumers. What thus results from all this is observable and characteristic phenomena such as the shortage economy, the destruction of natural resources, poor quality, slow technological progress, the deterioration of morale and incentive, et cetera. All this inherently results from the first block, and each succeeding block is caused by the previous ones and in turn the cause of following ones.

How would such an economy perform? We might expect a more equal distribution of income, stable nominal prices (but still hidden inflation as a result of increasing shortages), full employment, and rapid but slowing growth. As the centrally planned and managed economy is very effective at accumulating resources but terribly inefficient in using them, we would expect the classical socialist economy to be characterized by extensive, not intensive, growth. Such an economy, if initially less developed, might be able to grow very rapidly at first; in time, however, capital accumulation has diminishing marginal returns and other resources, once fully employed, cannot keep growing so rapidly. The poor incentive structure for technological progress, innovation, and efficient use of resources will in time lead to stagnation.

(20%) What is market socialism, and how, according to Lange, should it work? What are some of the chief criticisms of Lange's model? What is the Labor-Managed Economy (LME), and how does it differ in design from either the classical socialist economy or Lange's model? According to the Ward-Vanek-Domar model, what are its predicted benefits, and what are its predicted problems? Why did Furubotn argue that the LME would tend to be characterized by underinvestment?

In order to counter arguments by Ludwig von Mises that socialism could not allocate resources efficiently because markets were necessary to determine value, Oskar Lange proposed a model of "market socialism," in which free-price markets were used to allocate intermediate and consumer goods, while the state maintained ownership of resources, the means of production. Resource prices were to be set by the state on a trial-and-error basis to eliminate shortages or surpluses, and relatively autonomous SOE managers were to both set price equal to marginal cost and to minimize the average cost of production. Lange argued that this system would ultimately result in efficiency, but supporters of von Mises have argued that prices would still be "wrong" since producer prices would be slow to adapt, and that planners would have little ability to ensure that managers followed their rules. According to Jaroslav Vanek, the Labor-Managed Economy (LME) would be a form of "market socialism," with free occupational choice, free markets (except in natural resources and capital investment), and no directive planning, in which workers engaged in participatory management of their enterprises, enterprise income was shared by job assessment, and capital was rented from the state. Vanek argued that the LME would have improved incentives for efficient production compared to the Centrally-Planned Economy (CPE), since markets determine prices and worker's income depends on profits, and that it would be more equitable than capitalism. The LME still relies on state ownership like the CPE, but not direct state planning. It uses markets like other market socialist models, but lets workers manage the firm rather than state managers.

Ward's model (also called the Ward-Vanek-Domar model) describes a labor-managed enterprise which maximizes average income per worker, and it predicts that profitable enterprises would hire too few workers, since the marginal worker's contribution (marginal product) was less than the income to be shared with him (average product). It also predicts that the enterprise could exhibit a perverse price response, reducing its workforce and output as output prices increase. In monopoly markets, the enterprise would have a greater incentive to raise its price and reduce its quantity. Furubotn predicted that the enterprise would not invest sufficiently out of current profit, since individual property rights over future income are ill-defined in a socialist economy.

In large part, the problems of labor management result from undefined property rights over investment and profit. In a socialist economy, this problem would be difficult to resolve since private ownership of capital is viewed as inherently exploitative. In a capitalist economy, which suffers no such compunction about defining private property rights, labor management can work where physical capital is less important than human capital. Doctors, lawyers, architects, management consultants, and software engineers commonly organize their business as partnerships that are often "labor-managed."

(15%) Compare and contrast War Communism and the New Economic Policy, explaining their historical context, policies, and results. Describe the debate which followed them, and explain how the debate was ultimately resolved.

War Communism was a disastrous policy of Lenin's during the Russian civil war of 1917-1921, after the Bolshevik Revolution, which attempted to leapfrog over Socialism into full Communism. Civilian workers were organized into labor armies, use of money was curtailed, firms were nationalized and put under control of the central planning agency Vesenkha, agricultural production was extracted rather than taxed, rationing was implemented, and millions of people starved to death in drought and famine.

Once the civil war ended, Lenin said, "we are not civilized enough for socialism." He admitted that Russia was still primarily an agrarian nation, with a small urban population and a weak industrial base, and he announced the New Economic Policy, to take "one step backwards" in order to later be able to take two steps forward into socialism and communism. Russia returned to more market-oriented production incentives, peasants were encouraged to get rich by producing more while paying taxes, labor protections were passed, small state-owned firms were leased to entrepreneurs, and the government released its monopoly over trade. There were also efforts to normalize relations with the rest of the world.

The NEP lasted from 1921 to 1928 and led to recovery of the Soviet economy, but it also led to a debate within the Communist Party of the Soviet Union over the best way to achieve socialism. On one side was the Left Deviation, the Teleologists led by Trotsky and Preobrazhensky. They advocated the return of the state monopoly over trade and agriculture, especially after falling food prices (the so-called "scissors crisis") increased fears that farmers would not supply enough food for industrial workers, and a rapid shift towards centrally planned socialism. They worried about "capitalist encirclement," which illustrated the need for rapid industrialization and militarization, and also the potential re-emergence of capitalism. On the other side was the Right Deviation, the Geneticists led by Bukharin. They advocated continuation of NEP and a gradual movement towards planned socialism that took into consideration current conditions, the need for incentives, and the Smychka alliance between workers and farmers. The debate was ultimately resolved by Stalin, who eliminated most of the leaders on both sides of the debate and implemented the Soviet Union's first five year plan along teleological lines in 1928.

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