

I. (45%) Short Descriptions: Answer 15 of 18 (3% each)

1. Basic Organization of Associated Labor – *the labor-managed groups in the former Yugoslavia, which would join in self-management agreements to run firms that would have been state controlled in other socialist economies. Workers would share in profits and jointly manage their firms.*
2. Basic Bank – *the regional banks essentially controlled by the Yugoslavian BOALs, which often tended to lend excessively, which contributed to inflation as the central government had to bail them out.*
3. Codetermination – *the German labor policy, also known as mitbestimmung, in which large firms are required to allow labor representatives to serve on their supervisory boards.*
4. Control by Ruble – *the policy of the Soviet Gosbank to check all internal transactions against the central plan. Because cash was limited to use by workers/consumers and the bank was a monobank, the account drafts between firms was supposed to match the movement of goods between firms.*
5. Indicative Planning – *an approach used by the French after WWII, in which labor, management, and government met to create five-year-plans with voluntary targets. The goal is to provide information, coordinate investment and build a consensus.*
6. Iron and Rye Alliance – *the protectionist policies of Chancellor Otto von Bismarck after German Unification, in which high tariffs were levied on imports of both agricultural and industrial products.*
7. Limited Liability Corporation – *a corporate form of ownership pioneered in the U.S., in which investors are not liable for the debts of the firm beyond their contributed investment. It made it much easier to have larger private firms.*
8. Main Bank System – *the Japanese postwar Keiretsu system, in which firms were organized into mutual support networks around a bank, more like competitive oligopolies relative to the more monopolistic Zaibatsu.*
9. Material Balance Planning – *a system of quantity-based planning using linearized input-output equations, that set targets for firms on what and how much to produce. As a method of allocating resources, it had many flaws.*
10. Monobank – *the Soviet-style monopoly bank, e.g., Gosbank, in which the state held all savings, allocated all investment, and monitored firm transactions (see control by Ruble).*
11. Nationalization – *a government policy of taking over ownership of privately-owned firms. The opposite of privatization.*
12. Perestroika – *Gorbachev's "restructuring" policy of the late 1980s to try to save the Soviet economy by using radical reforms and market-oriented incentives. These were inconsistently or incompletely implemented, and did not succeed.*
13. Reserve Fund System – *the Swedish system of investment stabilization, in which tax benefits were available for firm savings in the Riksbank, under the condition that the National Labor Market Board had to approve when and where it was spent.*
14. Smychka Alliance – *Bukharin's argument that farmers and workers needed to both be equal partners of Soviet development after the Bolshevik Revolution, in contrast to the Marxist presumption that the workers alone were the revolutionary class.*
15. Uskorenye – *Gorbachev's initial policy of "Acceleration" in the 12th Five-Year Plan of the late 1980s, which tried to improve quality, retool industry, reduce alcoholism, et cetera. It was a failure.*
16. Visible Hand – *the Yugoslavian reforms of 1951 under Marshall Tito, which decentralized power to local and republic governments and workers' councils, reduced administrative pricing and created rural and urban markets, and allowed state enterprises to set their own output targets. This later led to the creation of a labor-managed market-socialist economy.*
17. Wage Solidarity – *the Swedish labor policy of having the highest gains in pay go to the lowest paid workers.*
18. Weimar Inflation - *Because the Treaty of Versailles forced Germany to pay reparations it could not afford, the German Weimar government covered its budget deficit by printing new money. Between 1921 and 1923, the money supply rose 7.5 million times, prices rose 88 billion times, savings were wiped out and the economy was devastated.*

II. (40%) Short Answers.

1. Many argue that the U.S. government just keeps getting bigger. Put this into historical perspective, and compare it to other capitalist countries. How did this correlate with per-capita income growth and macroeconomic stability?

The U.S. federal government grew substantially during the 20th Century, from roughly 4% of GDP before FDR to an average of almost 23% by the early 1980s, but as a share of GDP the amount of government spending has not grown since, even once you add in state and local governments which account for perhaps 12% of GDP. That is, government has continued to grow, but roughly at the same rate as the overall economy. The government of the U.S. has grown less and remains proportionately smaller (though still larger in absolute terms) than in almost all other developed market economies. Contrary to expectations, the available evidence does not seem to demonstrate that this growth in government was bad for economic performance: in per-capita terms, the economy has grown faster since government got bigger than before, and rates of growth and even price inflation have become much more stable as well.

2. What was Japan's record of economic growth, both before and after WWII? Why did this change after 1989? What role did the Japanese financial system and the Bank of Japan play in this change?

Before WWII, Japan had been one of the world's fastest-growing economies after the Meiji Restoration and Japan's rapid modernization (and militarization, unfortunately). After WWII, Japan became the fastest growing economy until the 1970s, and continued to grow rapidly through the bubble economy of the late 1980s. In 1990 the bubble popped, and many banks found themselves unable to lend for productive investments in spite of Japan's high savings rate because of a growing bad debt problem. The financial system had long been devoted to the needs of the Keiretsu, and many of these firms were highly leveraged using short-term debt, but the financial liberalization of the 1970s and early 1980s led to a push into real estate and construction loans, with regulation that failed to evolve accordingly. The Bank of Japan enabled the bubble to occur through an easy monetary policy after the Louvre Accord of 1987, popped the bubble with tightening money, and failed to change course when the economy slowed. The Japanese government also tried to bail out insolvent firms without really addressing the behavioral problems. Sound familiar? As a result, the Japanese economy's growth trajectory flattened considerably.

3. What is the German *Sozialmarktwirtschaft*, or "Social Market Economy"? What are its philosophical sources? What are some of the primary components of government policy that define it?

The German Sozialmarktwirtschaft, or "Social Market Economy," is the economic system designed for the new Bundesrepublik Deutschland by the Freiburg School of Alfred Müller-Armack, which attempted to combine the concept of the Sozialstaat, an interventionist philosophy of justice between groups and a balance of power, with the Sozialer Rechtsstaat, a more laissez faire system of individual rights and equality before the law. The power of the central government is limited by a federal system, though the federal chancellor has significant power. Fiscal policy has generally been noninterventionist, the government has made no effort at planning, and Germany's central bank, the Deutsches Bundesbank, followed conservative monetarist policies that led to one of the lowest inflation rates in the postwar period. On the other hand, the government provides an extensive welfare system and generous unemployment benefits, the government has promoted savings and capital ownership for workers, and Germany's labor and product markets are highly regulated, For example, labor unions are required to have seats on most large corporate boards.

4. Explain the great debate between the teleologists and the geneticists after the death of Lenin. How was the debate eventually resolved?

The "great debate" took place in the new Soviet Union after the death of Lenin, following the introduction of his New Economic Policy and the recovery of the economy. The "Left Deviation" was known as the teleologists, and included Trotsky and Preobrazhensky. They cited the need for rapid industrialization and militarization due to the threat of capitalist encirclement. They also feared the emergence of a new capitalist class due to the NEP's reliance on markets and material incentives. They advocated bringing back the state monopoly over trade and agriculture that had been imposed during War Communism, and a rapid shift to a centrally-planned socialist economy. The "Right Deviation" was known as the geneticists, and included Bukharin. They advocated a gradual movement towards planned socialism, continuation of the NEP, and the Smychka alliance between workers and farmers. They cited the need to consider Russia's current condition as a predominantly agricultural society, and thought the best way to build up a surplus for industrial development was to give farmers private material incentives to grow more crops. The great debate was resolved when Stalin eliminated most of the leaders of both sides, and instituted the first five-year plan in 1928.

5. What is the labor-managed economy? How is it supposed to work, and why is it supposed to be an improvement over the classical socialist economy? What are the problems of the labor-managed firm under socialism?

A labor-managed economy is a variant of market socialism, in which workers effectively own the firm instead of the state, sell their output on markets, and share the profits. On one hand, this should improve the worker's incentive to produce without creating a new capitalist class. On the other hand, the maximization of profit per worker leads potentially profitable firms to hire too little labor, since the labor will be effectively more expensive if profit must be shared, and too much demand for labor for unprofitable firms. This could lead to a perverse price response, if capital and labor are complements more than substitutes, since an increase in price increases average profits more than it increases the value of labor's marginal product. The sharing of profits also leads to a tendency to rely too much on debt, rather than self-invested equity, and if capital markets are undeveloped this would lead to inadequate investment. Finally, this system potentially creates inequality, not between capitalists and workers, but between workers in one firm and workers in another.

III. (15%) Essay Question.

- A. What are Janos Kornai's five steps of the classical socialist economy, and what is the fundamental condition that defines whether an economy is socialist? How do these steps fit together as a system? How does his model explain the shortage economy? How does Kornai's explanation contrast with that of the Fel'dman model, and why?

Kornai argued that the classical socialist economy could be described in five steps, or blocks, in order of causality: power, property, coordination, behavior, and phenomena. The essential element of socialism is the unchallenged power of a Marxist-Leninist communist party, which believes itself to be the vanguard of 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, chronic shortages, investment hunger) 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.

Kornai explains the shortage economy as the inevitable outcome of a system which uses bureaucratic means to allocate goods, and it is self-replicating through behaviors like hoarding. The Fel'dman model suggests that shortages are intentional rather than inevitable. In the Fel'dman model, the state attempts to achieve rapid growth through forced savings and a bias towards heavy industry or producer goods. Consumer goods are underproduced and underpriced, so workers cannot spend their income and firms don't have to pay them much. Workers therefore are forced to save, and producer goods industries make high profits, both of which are channeled through the state-owned banking system into more investment in producer goods industries.

- B. Compare the postwar economic performance of Germany, France, and Sweden. What were the unique economic policies in each country, and what policies did they share? To what extent can these policy similarities and differences explain their postwar growth record?

These three western European economies all grew at impressive rates during the postwar period. Germany was devastated by the Depression and the war, and France has also experienced several decades of stagnation before the war, while Sweden had managed to emerge from both the Depression and the war relatively unscathed. Germany experienced the "economic miracle" through the 1970s, with real growth in per-capita income of roughly 5% per year, but Sweden and France also grew relatively rapidly at about 3.5% per year. By the 1970s, at official exchange rates at least, Sweden had one of the world's higher per-capita incomes, while France and Germany had overtaken the UK.

While all three economies came to share a relatively generous set of social policies, they differed in other ways. France relied on a system of indicative planning, and had a large number of state-owned firms. Germany had strong unions, but little nationalization and a fairly conservative fiscal and monetary policy, while Sweden used a system of centralized collective bargaining and an active labor market policy.

After the 1970s, these economies began to slow. Sweden was an export-oriented economy that went through a series of currency devaluations to reignite growth, and this led to a significant recession in the early 1990s when they tried to stop the cycle of devaluation during the European financial crisis. France pushed too far on planning, nationalization, and welfare under Mitterrand in the 1980s, and was forced into a political stalemate with rising unemployment. Germany's growth slowed somewhat after 1975, but really declined after reunification with East Germany in 1990. One can ascribe the shared slowing of growth to excessive labor and product market regulation, or to an overly generous welfare state, but the correlation is not highly correlated with their similarities or differences, especially over time.