

1. Describe the political and economic philosophy underlying the attempts to create a new socialist society and economy? What were the moral justifications for a socialist revolution? What was the idea of man in the communist thinking?

The writings of Karl Marx and Frederick Engel provided the backbone of the political and economic philosophy fuelling the creation of a new socialist society and economy. Providing a critique on capitalism and a brief description of a socialist and communist society, the main messages adopted from Marx and Engels were the inherent failure within the capitalistic system. The end goal of Marxist ideology is to have a complete societal transformation to a classless society. Directly, there were limited directions for economic policy; however certain concepts were adopted by the early Revolutionaries of the Communist party. The recent wars of the world were accepted as being attributed to economic interests. The devastation that occurred as a result of the wars made the classless and peaceful portrait of Marxist ideology and a Marxist society appealing. The foundation of the ideology is a description of the present and the long-run for both communism and capitalism.

After the Revolution in October of 1917 reformists across Europe were congregating into a coherent body whose direct descendant was the Socialist International. Joining the Communist International set up by Lenin in 1919, adherence to Lenin's "democratic centralism" became compulsory; Communist parties as well as the Soviet state followed this outline and had the following features: take control of the state and all political power with one ruling party who adheres to a hierarchy, no legal limitation of state power, monopoly party control over all forms of social organization, and monopoly party control over communication with the right to censor and mandate public opinion (Steinherr)

Marx defined a communist society as one being governed by the principle “from each according to his ability, to each according to his needs”. Recognizing that this utopia could not be immediately achieved by society, an interim structure would be implemented referred to by Marx as socialist. Under the socialist framework the ruling class would be the result of the division that occurred as “from each according to his ability, to each according to his work” differentiated the victorious workers who were to become the ruling proletariat (Lavigne 4).

Marx concluded that capitalism is “doomed to fail”. This conclusion fueled the Communist party in rejecting any aspect of capitalist ideology. Not only germane to the policy conclusions for the Communist party, the acceptance of the Marxist conclusion of the inherent failure of capitalism provided the moral justification of the workers' class interest (Gros, 18). This moral justification justified the price controls for food, redistribution of wealth and land, and the provision of education and health services by the state.

The initial confiscation of wealth and property was the processes of “expropriating the expropriators”. As written by Marx in 1867 in Capital, Volume I chapter 32, the expulsion of private property as conceived by capitalist economies is necessary:

“Centralization of the means of production and socialization of labor at last reach a point where they become incompatible with their capitalist integument. Thus integument is burst asunder. The knell of capitalist private property sounds. The expropriators are expropriated”

Following the land revisions, new industrial economic policy demanded that output be directed towards the production of arms. This transformation of industry was an interpretation of Marx writing that “the country that is more developed industrially only shows, to the less developed, the image of its own future.” (Marx). The duplication of technologies became an

economic tactic to foster growth based on the backwardness of the economic condition. In reality, the ideology of the socialist economic system had only a few parallel with the ideologies of Marx and Lenin, from whom only a few, yet integral quotations were borrowed. (Lavigne, 4)

2. The economy of Soviet Union can be looked at as one huge enterprise. Describe the main organizational task to run this or any enterprise. What are the similarities with and differences to a “normal” enterprise in a market economy? Why may this comparison be misguided after all?

The Soviet Union operated like one huge enterprise. There are three common features among all countries which belong to the 'socialist economic system', the economic system of the Soviet Union. First, the economic control is under the control of a certain single party. Next, the economic institutions were based upon collective, or state, ownership of the basic means of production. Third, compulsory central planning was the main coordinating mechanism (Lavigne, p. 3).

The party itself was a series of divisions operating under one dictator. The lowest level was comprised of enterprises and collective farms. The lowest level was organized into collective units with a manager to ensure that production targets were met and political instructions were followed. Immediately after the takeover, the communists organized nationalization and production on an industry-by-industry basis. All firms within a given industrial sector were brought under the umbrella of the Supreme Economic Council (Gros, 20), which reported the state. Due to the vast expanse of territory under the control of the Communist party or state, the network was massive and complex.

To spur economic development, energy prices were fixed at a rather low level. Energy was thought of as a basic ingredient to develop heavy machinery and allow the mechanization of the economy. A virtually unlimited amount of energy was available. Foreign trade relations to the non-socialist world were limited and served basically as a buffer against unexpected failures (as bad harvests) in the domestic economy (Lecture 9), and did not impact internal production. Because of price controls, the price signaling of goods and natural resources was cut off from the pricing systems within the Soviet economy (Gros, 52). The control of prices internally is part of a closed centrally planned economy.

The organizational and output levels for the Soviet Union economy were based off a program plan, which in its version of equilibrium is called a consistent plan. The plan targets for production, given in natural units or value units, were the dominant coordination mechanism in the Soviet economy. A consistent plan reflects plan targets that are equal to the input demand plus final demand for all products and services in the economy. The plan is mandatory in a socialist economy (Lavigne, p. 10). The plan aimed to be the instrument enabling the management of everything under socialist ownership and control. Poor performance and failure to meet the output targets was considered a violation of the state and harsh consequences were instilled.

The process of reaching a consistent plan was the result of numerous revisions of plan targets. The revisions would occur after an initial plan target was announced and firms would calculate their necessary inputs to achieve that certain output target, also called a gross out production target. After receiving information from individual firms about input demands, the

program target would be updated to reflect a new output target. After another correspondence with the individual firms the new input requirements would be incorporated into the updated program target, which was already reflecting the already augmented plan target. Eventually, after numerous correspondences, there would be a near convergence between the plan target and the necessary output and inputs for the economy. At the point of convergence a consistent plan would be decided. Repeating plan targets until reported required inputs plus final demand equaled the plan target level is the revision procedure the Soviet Union used. In reality, the planning office never tried to plan all products in the economy. In the Soviet Union, about 2,000 products were planned centrally and another 10,000 on the regional level (Lecture 9)

The development of the material balances was developed under Stalinist planning and was used in all socialist countries. A balance is a table that identifies domestic sources of supply and domestic uses of production (intermediates, outputs, investment, consumption) (Lavigne, p. 11). The procedure was iterative and never convergent (Lavigne, p. 12). The lack of convergence in the material balances was caused by lack of time, crude methodology, and biased reports and initial data. The only economy that would efficiently operate under a material balance plan is one that is implemented during war-time in a quasi-military discipline (Lavigne, p. 12). The planning system focused on increasing capital rather than operating at an optimal level of labor and capital combinations.

The planned economy lacked three main market economy institutions and also exhibited different decision making methods. The three main institutions that are not existent in a

planned economy are lack of private property, no central functioning financial system, and no appropriate tax system. The Marxist distinction between productive and non-productive activity creates a sizeable difference between Western national income accounting and material product accounting. Net material product (NMP) does not include most services. This will underestimate GDP and is likely to overestimate growth (Gros, 45). The plan is a coordination mechanism opposed to market (Lavigne, p. 10). There were plans covering different periods of time, one quarter, one month, one year, and five years. The one year plans were the most binding by nature because these were the targets that firms had to adhere. The transmission of managerial skills is a large benefit of international trade.

The inability to convert the goods and currency unit within the Soviet economy, the lack of economic transparency, and the inevitable economic future makes comparing the Soviet system to other systems or economic possibilities difficult.

- 3. How would you explain this phenomenon? Why doesn't anyone produce spare parts? What are the impacts of a shortage of spare parts on the system as a whole? What loopholes the firms/people found to deal with the problem? How might you change the incentives to produce more desirable outcomes?*

Aggregate output in the Soviet economy was determined by a strict production plan that encompassed all major goods within the Soviet Union economic borders. The production plan dictated output levels with given combinations of inputs. The production plan was based on multiple revisions to a base production target which would be augmented to new revised production targets. In an effort to keep his job, and sometimes his life, the manager's role was to successfully fulfil the plan target. The plan targets were accounted in a standard unit, most

commonly the metric ton (Lavigne, p. 13) and issued in volumes. The central planning office never planned all the products in the economy. The Soviet economy planned about 2,000 products centrally and 10,000 regionally (Lecture notes). In an entire economy there are far more products than 10,000. It is unclear how unauthorized production would occur without being deemed as deviance from the strictly enforced social code.

The plan target and its revisions were based off of reports from individual managers at firms the state imposed production plan did not accommodate a proper level of depreciation or individual demand for personal items and their maintenance. Because of the strict punishment for not successfully completing the demand of the production plan, there was incentive for the individual managers to report higher levels of necessary inputs for a lower level of output. This phenomenon is called the principal-agent problem and is substantiated by an incentive discrepancy between the manager and the owner. This is the case between the manager (principal) and the state (owner), and likewise between the state (principal) and the citizen (owner).

Over time the difficulty in acquiring necessary items resulted in firms internalizing as many levels of the production process as possible. After the production processes became more internalized the economy was populated by large vertically integrated conglomerates. The large conglomerates had monopoly power over negotiating plan targets and intermediary deliveries. The inherent disincentive to accurately report the process for a single entity was now experiencing a summation effect as the vertically integrated conglomerations formed. Firms would also create bargaining coalitions after firms providing inputs teamed with firms

producing outputs. The power of each bargaining group was determined by its size in terms of output, its strategic position in the output structure, and its strategic position for the political parties. Most requests are revised and finalized at a lower level than requested inevitably resulting in underfunding for most projects. There was unlimited demand for investment funds, however there was no price mechanism to elucidate the market and auction the funds (Gros, 43). The rejection of the capitalist idea of money led to the concept of Soviet money as being a crude unit of account with no real or physical backing to legitimize the currency. The lack of a legitimate currency mixed with poor management of production and zero capital mobility in the foreign market. The limited amount of imports and exports that were coordinated by the state and were severely export constrained.

Inventories within firms were kept rather secret and production methods lacked transparency. This magnified the principal-agent relationship. Firms were expected to declare all amounts of overages and ultimately firms were expected to operate with exact efficiency and have no overages. Some firms would sell their overages to the black market, or save them in secrecy towards future target plans.

The written passage for the essay states two main issues being reported. The first issue is a lack of access to spare parts for numerous consumer goods. The second issue was dishonest or unpredictable repair work. Both issues are rooted in the principal agent relationship. The lack of spare parts is a mix between the vast expanse of land being controlled by the target plan and the lack of mandating the delivery of spare parts within the target plan framework. One spare sewing machine screw

The lack of reliable repair work and lack of access to spare parts are two effects of the principal-agent phenomenon. The excessive bribes needed to complete repair work are because the repair shop had the option to sell off the parts into the black market. The presence of a black market is stated as having a large enough impact on the value added method to make the GDP calculations of Soviet economic times unreliable. Separate circulation of cash and non-cash payments allowed for a separate control of enterprise and consumer spending, the ultimate aim being the strict implementation of the plan (Lavigne, p. 14). Prices in a planned economy were fixed by the planning office and played only a marginal role in the economy. Prices were calculated on the basis of costs and social reasoning and were transacted in a currency that was inconvertible.

The overall impact of not having access to spare parts and black market activity was rapid depreciation of capital and state-owned items. This rapid depreciation was catalyzed by ordinary citizens having no incentive or attachment to state property (Lavigne, 10) and no availability to purchase outside of the Soviet economic network or outside of the state determined consumption bundle.

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