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—Leo Panitch, editor, *Socialist Register*

THE  
**CONTRADICTIONS**  
OF  
"REAL SOCIALISM"

THE CONDUCTOR AND THE CONDUCTED

**MICHAEL A. LEBOWITZ**





"A riveting exploration of what can be learned from the first attempts to create socialist systems, specifically the period from 1950 through the 1980s. Required reading."—**Fred Magdoff**, professor emeritus, University of Vermont

"One doesn't have to agree with all the theses presented in Michael Lebowitz's latest book in order to acknowledge that this is a major contribution to the international debate on socialism of the twenty-first century."—**Michael Löwy**, co-author, *Che Guevara: His Revolutionary Legacy* (with Olivier Besancenot)

"What would Marx have thought had he lived to see the Soviet Union? Nobody has interpreted Marx to greater advantage to answer this question than renowned Marxist scholar Michael Lebowitz, who explains why Marx would not have been pleased!"—**Robin Hahnel**, professor of economics, Portland State University

"We need this well-written book to understand that socialism did not die with the fall of the Berlin Wall."—**François Houtart**, Executive Secretary of the World Forum for Alternatives

"Where fresh insights are rare, indeed, Michael Lebowitz provides a bundle of them. Although no one will (or perhaps should) agree with everything here, the book provides rich material for badly-needed discussion."—**Paul Buhle**, author, *Marxism in the United States*

**Michael A. Lebowitz** is professor emeritus of economics at Simon Fraser University in Vancouver, Canada, and author of *The Socialist Alternative*, *Beyond Capital: Marx's Political Economy of the Working Class* (winner of the Isaac Deutscher Memorial Prize for 2004), *Build It Now: Socialism for the Twenty-First Century*, and *Following Marx: Method, Critique and Crisis*. He was Director, Program in Transformative Practice and Human Development, Centro Internacional Miranda, in Caracas, Venezuela, from 2006 to 2011.

MONTHLY REVIEW PRESS  
146 West 29th Street, Suite 6W  
New York, NY 10001  
[www.monthlyreview.org](http://www.monthlyreview.org)

cover design: Ben Smyth, Grand Opening

ISBN-13: 978-1-58367-256-3



9 781583 672563

CONTRADICTIONS OF REAL SOCIALISM  
MICHAEL A. LEBOWITZ

MR  
MONTHLY  
REVIEW  
PRESS





## Praise for *The Contradictions of 'Real Socialism'*

"The owl of Minerva only flies at dusk"—it was Hegel's old maxim that seemed confirmed when in 1991 the *Socialist Register* published Michael Lebowitz's article on the nature of "real socialism" amid its very demise. This new book takes off from there, but its wings are buoyed by Lebowitz's work since then, from *Beyond Capital* to *The Socialist Alternative*. The profound understanding in this new book of why twentieth-century attempts at constructing socialism failed must be an essential element in the socialist renewal emerging amid the first great capitalist crisis of the twenty-first century. It thus appears that the old wise owl also flies at dawn.

—LEO PANITCH, editor, *Socialist Register*

If we want socialism for the twenty-first century, we need to understand why the "real" socialisms of the last century so often ended in capitalism. In this book, Lebowitz shows, theoretically and historically, that the socialism practiced in the Soviet Union and Central Europe was doomed because vanguard relations of production weakened the working class, ensuring that it would have no primary role in the battle ultimately won by the logic of capital (represented by managers) over the logic of the vanguard (represented by the party). We must, he concludes, reject vanguard Marxism and embrace a Marxist vision of socialism in which, from the beginning, the full development of human capacities is actively promoted. There is a lot to learn here.

—MARTIN HART-LANDSBERG, professor of economics,  
Lewis and Clark College

One doesn't have to agree with all the theses presented in Michael Lebowitz's latest book in order to acknowledge that this is a major contribution to the international debate on socialism of the twenty-first century. Drawing lessons from the dramatic failure of so-called "real socialism," he argues, with powerful and persuasive logic, that a new society, based on values of solidarity and community, cannot be created by a state standing over and above civil society: only through autonomous organizations—at the neighborhood, community, and national levels—can people transform both circumstances and themselves.

—MICHAEL LÖWY, co-author, *Che Guevara: His Revolutionary Legacy*  
(with Olivier Besancenot)



What would Marx have thought had he lived to see the Soviet Union? Nobody has interpreted Marx to greater advantage to answer this question than renowned Marxist scholar Michael Lebowitz, who explains in *The Contradictions of 'Real Socialism'* why Marx would not have been pleased!

—ROBIN HAHNEL, professor of economics, Portland State University

We need this well-written book to understand that socialism did not die with the fall of the Berlin Wall.

—FRANÇOIS HOUTART, Executive Secretary of  
the World Forum for Alternatives

Where fresh insights are rare, indeed, Michael Lebowitz provides a bundle of them. Although no one will (or perhaps should) agree with everything here, the book provides rich material for badly-needed discussion.

—PAUL BUHLE, author, *Marxism in the United States*

A riveting exploration of what can be learned from the first attempts to create socialist systems, specifically the period from 1950 through the 1980s. Lebowitz convincingly demonstrates that the distortions of the model developed in the Soviet Union and copied in eastern European countries ("real socialism") were caused by setting in motion two contradictory forces—ending up with the worst aspects of both capital and leadership and control by a "vanguard." He examines the development of "real socialism" as a complex system, with the various parts explained and scrutinized in their interactions and interrelations as part of the system. Required reading for those interested in avoiding diversions and pitfalls in a post capitalist alternative—on the path to creating a system under social, instead of private, control in which the goal is meeting everyone's basic needs and encouraging and allowing the full human development of all.

—FRED MAGDOFF, professor emeritus of plant and soil science,  
University of Vermont





# The Contradictions of “Real Socialism”

*The Conductor and the Conducted*

by MICHAEL A. LEBOWITZ



MONTHLY REVIEW PRESS

*New York*



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Library of Congress Cataloging-in-Publication Data  
Lebowitz, Michael A.

The contradictions of real socialism : the conductor and the conducted /  
by Michael A. Lebowitz.

p. cm.

Includes bibliographical references and index.

ISBN 978-1-58367-256-3 (pbk. : alk. paper) — ISBN 978-1-58367-257-0  
(cloth : alk. paper) 1. Communism. 2. Socialism. I. Title.

HX73.L4163 2012

335—dc23

2012019992

Monthly Review Press  
146 West 29th Street, Suite 6W  
New York, New York 10001

[www.monthlyreview.org](http://www.monthlyreview.org)

5 4 3 2 1



## Contents

Preface .....	7
Introduction: New Wings for Socialism.....	11
Overture: The Conductor and the Conducted .....	21
1. The Shortage Economy .....	29
2. The Social Contract .....	49
3. The Nature and Reproduction of Vanguard Relations of Production.....	67
4. Contested Reproduction within "Real Socialism" .....	89
5. The Conductor and the Battle of Ideas in the Soviet Union .....	107
6. From Moral Economy to Political Economy.....	131
7. Toward a Society of Associated Conductors.....	153
8. Good-bye to Vanguard Marxism .....	173
Bibliography .....	189
Notes.....	195
Index.....	217





For friends in Cuba, Venezuela,  
and everywhere people are struggling to build a new world.

*Hasta la victoria siempre!*





## Preface

This is not a book for those who already know everything important there is to know about “Real Socialism.” For those fortunate souls who have inherited or adopted the eternal verities of particular political sects on the left, empirical footnotes that strengthen their claim to leadership are the principal tasks of scholarship. As a result, the central question about this book for them is likely to be, “Is he with us or against us?” In short, is this book good for the chosen?

I presume, however, readers who begin with questions rather than answers. What was this phenomenon known as “Real Socialism,” or “Actually Existing Socialism,” a concept created in the twentieth century by the leaders of countries in order to distinguish their real experience from merely theoretical socialist ideas? What were its characteristics? How was this system reproduced? And why did it ultimately yield to capitalism without resistance from the working classes who were presumably its beneficiaries?

I didn’t plan to write this book. My original idea was to include a few chapters on “Real Socialism” in my book *The Socialist Alternative: Real Human Development*, published by Monthly Review Press in 2010. The point I wanted to make is that the socialist alternative is an alternative not only to capitalism but also to “Real Socialism.” However, after drafting a few chapters based in particular on the experience of the Soviet Union



and Eastern Europe, I realized that this section of the book was “taking over” and demanded a book of its own. So, as I indicated in the Preface to *The Socialist Alternative*, I decided to shift this material plus a discussion of the Yugoslav experience with market self-management to a separate project, which I called “studies in the development of socialism.”

In my attempt to apply Marx’s methodology to the study of Real Socialism (hereafter noted without quotation marks), however, I found myself constantly surprised because the subject under investigation continually revealed new sides that had to be explored, sides that I hadn’t considered in my years of teaching the subject. As a result, the book grew in size and took much longer to complete than anticipated. And, its scope was reduced. First to go was the discussion of the Yugoslav experience, now put off to a future project. But in addition, the discussion of Real Socialism as such was itself truncated.

Originally, my plan was to analyze Real Socialism as a system that consolidated in the period after 1950 and then to follow that with a section on its historical development. My model in this respect was Marx’s treatment of capitalism in *Capital*, which revealed the nature of capitalism as a going system (its “being”) and then used that analysis as a guideline for examining the original emergence of the system (its “becoming”). So, Part I would explore the nature of a system dominated by what I have called “vanguard relations of production,” whereas Part II would consider the original emergence (or original accumulation) of those relations.

Accordingly, the chapters drafted for Part II took up topics like the emergence of the vanguard party in the USSR, NEP (the New Economic Policy), social relations within the countryside, and the theory of “primitive socialist accumulation.” Only the discussion of the 1930s remained to be done. But these questions, too, have been set aside for another work, for now.

This is not at all a book without premises. As the Introduction reveals, I start from an understanding that at the core of socialism is a focus upon human development, upon, indeed, the development of human capacities, a process inseparable from human activity. But that specter is not the subject matter of this book. We understand Real Socialism best, I suggest, not by proceeding from theory and the simple application of



## PREFACE

concepts from the study of capitalism but by beginning, as Marx did, from the real, concrete phenomena of these societies and by trying to grasp the underlying structure that generates them.

Our examination of Real Socialism begins by investigating an omnipresent characteristic in the system—shortages. To understand the factors underlying the “shortage economy,” we consider first the concept of a particular social contract that offered some definite benefits for the working class, and then we explore the character of vanguard relations of production. But there was more to Real Socialism than one set of relations. We see an inherent struggle between the logic of the vanguard and the logic of capital; in addition, we see a particular set of beliefs on the part of the working class (the moral economy of the working class in Real Socialism), which provides glimpses of an alternative logic, the logic of the working class. Can the latter be built upon in Real Socialism? That is the question for which we provide some suggestions but no definitive answer.

Although the focus is to move from concrete phenomena to an understanding of those phenomena, we begin the book with two abstract sections. Firstly, the Introduction presents my premises about capitalism and the concept of socialism for the twenty-first century. In this respect, it provides a bridge between the discussion in *The Socialist Alternative* and this book. Secondly, “The Overture” introduces the question of the conductor and the conducted (the subtitle of this book). It specifically poses a question about the need for a “directing authority” and the issue of power. Indeed, the Overture introduces the leitmotif of the book: the possibility of socialism in a society divided into conductor and conducted.

Once again, I need to point out that this book owes much to the encouragement, commitment, and comradeship of my partner Marta Harnecker (whose work ethic makes my reputed workaholicism appear like the behavior of a sloth). I have benefited much, too, from David Mandel, who has read several parts of this book and has offered useful critical comments. Finally, especially encouraging (and daunting) have been messages from a number of people who have told me how much they are looking forward to this book. I hope that I have raised the right questions for them.

—MICHAEL A. LEBOWITZ, MARCH 25, 2012



Bishop, I can fly,  
The tailor said to the Bishop.  
Just watch how it works.  
And he climbed with things  
That looked like wings  
To the broad, broad roof of the church.  
The Bishop passed by.  
It's all a lie,  
Man is no bird,  
No one will ever fly,  
The Bishop said of the tailor.

The tailor is done for,  
The people said to the Bishop.  
It was the talk of the fair.  
His wings were smashed  
And he was dashed  
On the hard, hard stones of the square.  
Toll the bells in the steeple,  
It was all a lie,  
Man is no bird,  
No one will ever fly,  
The Bishop said to the people.

—BERTOLT BRECHT <sup>1</sup>



## INTRODUCTION

## New Wings for Socialism

In 1990, I began an essay (bearing the subtitle “A Cautionary Tale”) with Brecht’s poem about the tailor who put on “things that looked like wings,” climbed to the roof of a church, tried to fly, and crashed.<sup>2</sup> In 1990, what many called the socialist world crashed.<sup>3</sup> And, everywhere there were experts who saw this as proof: socialism had failed. *No one will ever fly.*

What I attempted to do in that essay was to challenge the theoretical arguments against socialism, theoretical arguments in particular against the Marxist case for socialism. And I proposed that there had been a distortion of Marxism both in theory and in practice—a distortion that forgot about human beings, a determinist message focusing upon productive forces that was silent about “the nature of human beings produced within an economic system.” The determinist argument that stresses the primacy of productive forces, I argued, could never understand why Marx sacrificed his “health, happiness and family” to write *Capital*. Nor could it make sense of why Marx never stopped stressing that workers can make themselves fit to create a new society only through the process of struggle.

What was my essential point? It was to emphasize the importance of developing a new common sense—one that sees the logic of producing



together to satisfy human needs. The failure to do this and to stress instead the development of productive forces, I proposed, leads inevitably to a dead end—the dead end that we could see in front of us. The point was simple: as Che Guevara stressed, to build socialism it is essential, along with building new material foundations, to build new human beings.

But how? I focused upon a number of elements. Self-management in the process of production, I argued, was an essential element: “Insofar as people produce themselves in the course of all their activities, the very process of engaging in democratic forms of production is an essential part of producing people for whom the need for cooperation is second nature.” But self-management in particular productive units is not sufficient. You need, I argued, to replace a focus on selfishness and self-orientation with a focus on community and solidarity, a conscious emphasis upon human needs; that is, the necessity to engage in collective solutions to satisfy human needs must be “recognised as a responsibility of all individuals.” And, producing people with these characteristics could never be achieved by a state standing over and above civil society. “Rather, only through their own activities through autonomous organisations—at the neighbourhood, community and national levels—can people transform both circumstances and themselves.” What, in short, was necessary was “the conscious development of a socialist civil society.”

Thus I stressed the centrality of human beings and the development of the institutions that permit them to transform themselves. This had not occurred in the Soviet model. “With its lack of democratic and cooperative production, its absence of a socialist civil society and its actually existing bureaucratic rule,” Real Socialism had not produced the new human beings who could build a better world. And that, I proposed, was the lesson we had to learn from this experience. Rather than concluding from the crash that socialism had failed and that no one would ever fly, the lesson for socialists was different. My concluding line was: “No one should ever again try to fly with those things that only *look* like wings.”





## IN THE ABSENCE OF AN ALTERNATIVE

A lot has occurred since 1990 when that essay was written. However, one thing that has not changed is that, now as then, the absence of a vision of a socialist alternative ensures that there is no alternative to capitalism. If you don't know where you want to go, no road will take you there. The result is that you end up going nowhere—or, more precisely, your struggles are either defeated or absorbed within capitalism.

For many critics of capitalism, though, the system is on the verge of collapse. It is fragile—requiring for some only a cacophony of loud “No’s or a resounding chorus of “silent farts” for it to crumble.<sup>4</sup> For others, since capitalism is about to enter its final economic crisis (or, indeed, has been in it for decades), it is time to document the dying days of this doomed system.<sup>5</sup> But for Marx, it was *not* so simple—capitalism was not fragile. Despite his hatred of a system that exploited and destroyed both human beings and nature, he understood that capitalism is strong and that it tends to create the conditions for its reproduction as a system.

Capitalism is a system centered upon a relationship between capitalists, owners of the means of production who are driven by the desire for profits (surplus value), and workers who are separated from means of production and who have no alternative to maintain themselves but to sell their capacity to perform labor (labor-power). But how, Marx asked, does such a system reproduce itself? How are its premises produced and reproduced?

From the side of capital, this is easy to understand. Through its purchase of labor-power, capital obtains both the right to direct workers in the labor process as well as property rights to what the worker produces. It uses these rights to exploit workers (that is, to compel the performance of surplus labor) and thus to produce commodities that contain surplus value. What capital wants, though, is not those impregnated commodities but to make real that surplus value in the form of money by selling those commodities.

With the successful sale of those commodities (and, thus, the realization of the surplus value), capital is able to renew the means of production consumed in the process of production, hire wage-laborers



again, maintain its own desired consumption and accumulate capital for the purpose of expansion. However, capital's ability to continue to operate as capital requires the reproduction of workers as wage-laborers (that is, as workers who reappear in the labor market to sell their labor-power in order to survive). But what ensures this? While capital constantly tries to drive wages down, workers push in the opposite direction. So what ensures that workers will not gain sufficient wages to extract themselves from the need to sell their ability to work in order to survive?<sup>6</sup>

One way capital keeps wages down is by dividing and separating workers so they compete against each other rather than combine against capital. Not only can capital do this by using workers against each other (as Marx described the way capital took advantage of the hostility between English and Irish workers) but also it constantly reproduces a reserve army of the unemployed by substituting machinery for workers. The competition among workers and the division into employed and unemployed both tend to keep wages down. "The great beauty of capitalist production," Marx commented, is that by producing "a relative surplus population of wage-labourers," wages are "confined within limits satisfactory to capitalist exploitation, and lastly, the social dependence of the worker on the capitalist, which is indispensable, is secured."<sup>7</sup>

Yet Marx offered an additional reason for the reproduction of wage-labor (and thus the reproduction of capitalist relations of production). Workers are not only exploited within capitalist relations—they are also *deformed*. If we forget this second side of capitalist oppression, we can never understand why workers fail to rise up when capital enters into one of its many crises. We need, in short, to understand the nature of the workers produced within capitalism.

While capital develops productive forces to achieve its preconceived goal (the growth of profits and capital), Marx pointed out that "all means for the development of production" under capitalism "distort the worker into a fragment of a man," degrade him and "alienate him from the intellectual potentialities of the labour process."<sup>8</sup> *Capital* explains the mutilation, the impoverishment, the "crippling of body and mind" of the worker "bound hand and foot for life to a single specialized operation" that occurs in the division of labor characteristic of the capitalist



process of manufacturing. But did the development of machinery permit workers to develop their capabilities? The possibility was present but in capitalism this *completed* the “separation of the intellectual faculties of the production process from manual labour.”<sup>9</sup> In short, thinking and doing become separate and hostile, and “every atom of freedom, both in bodily and in intellectual activity” is lost.

A particular type of person is produced within capitalism. Producing within capitalist relations is a process of a “complete emptying-out,” “total alienation,” the “sacrifice of the human end-in-itself to an entirely external end.”<sup>10</sup> How else but with money, the true need that capitalism creates, can we fill the vacuum? We fill the vacuum of our lives with *things*—we are driven to consume. In addition to producing commodities and capital itself, capitalism produces a fragmented, crippled human being, whose enjoyment consists in possessing and consuming things. More and more things. Capital constantly generates new needs for workers and it is upon this that “the contemporary power of capital rests”; every new need for capitalist commodities is a new link in the golden chain that links workers to capital.<sup>11</sup>

Is it likely, then, that people produced within capitalism can spontaneously grasp the nature of this destructive system? On the contrary, the inherent tendency of capital is to produce people who think that there is no alternative. Marx was clear that capital tends to produce the working class it *needs*, workers who treat capitalism as common sense:

The advance of capitalist production develops a working class which by education, tradition and habit looks upon the requirement of that mode of production as self-evident natural laws. The organization of the capitalist process of production, once it is fully developed, breaks down all resistance.<sup>12</sup>

Breaks down all resistance! And Marx proceeded to add that capital’s generation of a reserve army of the unemployed “puts the seal on the domination of the capitalist over the worker” and that the capitalist can rely upon the worker’s “dependence on capital, which springs from the conditions of production themselves, and is guaranteed in perpetuity by



them.”<sup>13</sup> Obviously, for Marx, capital’s walls will never crumble with a loud scream.

Of course, workers *do* struggle against capital for specific goals—they struggle for better wages, workdays of lower length and intensity and for benefits that will allow them to satisfy more of their needs within this wage-labor relation. However, no matter how much they may struggle on particular questions such as questions of “fairness” (for example, “fair” wages, “fair” day’s work), as long as workers look upon the requirements of capitalism “as self-evident natural laws,” those struggles occur within the bounds of the capitalist relation. In the end, their subordination to the logic of capital means that faced with capitalism’s crises, they sooner or later act to ensure the conditions for the reproduction of capital.

And *that* is why Marx wrote *Capital*. Precisely because of capital’s inherent tendency to develop a working class that looks upon capital’s requirements as common sense, Marx’s purpose was to explain the nature of capital to workers and to help them to understand the necessity to go beyond capitalism.<sup>14</sup> Understanding that capitalism is a perverse society that deforms people and that capital itself is the result of exploitation, however, is *not* enough. If people think there is no alternative, then they will struggle to do their best within capitalism but will not waste their time and energy trying to achieve the impossible.

Here is why the story of the fall of Real Socialism is so important. It serves as a “cautionary tale”—socialism, we are told, cannot succeed. It was all a lie. No one will ever fly. There is no alternative. For so many, the story of Real Socialism killed the idea of a socialist alternative.

As Marx understood, ideas become a material force when they grasp the minds of masses. For many years, as the result of characteristics of Real Socialism (as well as its ultimate fall), people unhappy with capitalism have been convinced there is no alternative, that the logic of capital is common sense and that, accordingly, the best hope is capitalism with a human face. The result has been to strengthen capitalism.

For this reason, to understand Real Socialism and why it crashed is not an exercise in the study of history (like the study of feudalism). Rather, we know now—more clearly than in 1990—that there *must* be an alternative. There must be an alternative to a system that by its very



nature involves a spiral of growing alienated production, growing needs and growing consumption—a pattern the earth cannot sustain. The specter we face is that of barbarism—not only because of the limits of the earth (reflected in the evidence of global warming and the growing shortages that reflect rising demands for the earth's resources) but also because of the growing competition for those resources—a competition not likely to be left to the market.

### A NEW VISION:

#### SOCIALISM FOR THE TWENTY-FIRST CENTURY

There is, though, a new vision of socialism that has emerged in the twenty-first century as an alternative to barbarism. At its core is the alternative that Marx evoked in *Capital*: in contrast to a society in which the worker exists to satisfy the need of capital for its growth, Marx pointed to “the inverse situation, in which objective wealth is there to satisfy the worker's own need for development.” Human development, in short, is at the center of this vision of the alternative to capitalism.<sup>15</sup>

From his early discussion of a “rich human being” to his later comments about the “development of the rich individuality which is as all-sided in its production as in its consumption,” the “development of all human powers as such the end in itself” and “the all-around development of the individual,” Marx focused upon our need for the full development of our capacities; this is the essence of his conception of socialism—a society that removes all obstacles to the full development of human beings.<sup>16</sup>

But Marx always understood that human development requires practice. It does not come as a gift from above. His concept of “revolutionary practice,” that concept of “the coincidence of the changing of circumstances and of human activity or self-change,” is the red thread that runs throughout his work.<sup>17</sup> In every process of human activity, there is more than one product of labor. Starting from his articulation of the concept of “revolutionary practice,” Marx consistently stressed that, through their activity, people simultaneously change as they change circumstances.





We develop ourselves, in short, through our own practice and are the products of all our activities—the products of our struggles (or the lack of same), the products of all the relations in which we produce and interact. In every human activity, in short, there is a *joint product*—both the change in the object of labor and the change in the laborer herself.<sup>18</sup>

Marx's unity of human development and practice constitutes the *key link* we need to grasp if we are to talk about socialism. What kind of productive relations can provide the conditions for the full development of human capacities? Only those in which there is conscious cooperation among associated producers; only those in which the goal of production is that of the workers themselves. Worker management that ends the division between thinking and doing is essential—but clearly this requires more than worker management in individual workplaces. They must be the goals of workers in society, too—workers in their communities.

Implicit in the emphasis upon this key link of human development and practice, accordingly, is our need to be able to develop through democratic, participatory and protagonistic activity in every aspect of our lives. Through revolutionary practice in our communities, our workplaces, and in all our social institutions, we produce ourselves as “rich human beings”—rich in capacities and needs—in contrast to the impoverished and crippled human beings that capitalism produces. This concept is one of democracy *in practice*, democracy *as practice*, *democracy as protagonism*. Democracy in this sense—protagonistic democracy in the workplace, protagonistic democracy in neighborhoods, communities, communes—is the democracy of people who are transforming themselves into revolutionary subjects.

We are describing here one element in the concept of socialism for the twenty-first century—a concept of socialism as a particular organic system of production, distribution and consumption. *Social production organized by workers* is essential for developing the capacities of producers and building new relations—relations of cooperation and solidarity. And if workers do not make decisions in their workplaces and communities and develop their capacities, we can be certain that *someone else will*. In short, protagonistic democracy in all our workplaces is an essential condition for the full development of the producers.



But there are other elements in this socialist combination. The society we want to build is one that recognizes that “the free development of each is the condition for the free development of all.” How can we ensure, though, that our communal, social productivity is directed to the free development of *all* rather than used to satisfy the private goals of capitalists, groups of individuals, or state bureaucrats? A second side of what President Chavez of Venezuela called on his *Alo Presidente* program in January 2007 the “elementary triangle of socialism” concerns the distribution of the means of production.<sup>19</sup> *Social ownership of the means of production* is that second side. Of course, it is essential to understand that social ownership is not the same as state ownership. Social ownership implies a profound democracy—one in which people function as subjects, both as producers and as members of society, in determining the use of the results of our social labor.

Are common ownership of the means of production and cooperation in the process of production, however, sufficient for “ensuring overall human development”? What kind of people are produced when we relate to others through an exchange relation and try to get the best deal possible for ourselves? This brings us to the third side of the triangle: *satisfaction of communal needs and communal purposes*. Here, the focus is upon the importance of basing our productive activity upon the recognition of our common humanity and our needs as members of the human family. In short, the premise is the development of a solidarist society—one in which we go beyond self-interest and where, through our activity, we both build solidarity among people and at the same time produce ourselves differently.

These three sides of the “socialist triangle” form members of a whole. They are parts of a “structure in which all the elements coexist simultaneously and support one another”—an organic system of production, distribution, and consumption. Associated producers working with socially owned products of past labor to produce for social needs reproduce their conditions of existence through their activity.<sup>20</sup> “In the completed bourgeois system,” Marx commented about capitalism, “every economic relation presupposes every other in its bourgeois economic form, and everything posited is thus also a presupposition; this





is the case with every organic system.”<sup>21</sup> It is also true of socialism as an organic system: every economic relation presupposes every other in its socialist economic form in the completed socialist system.

### THINGS THAT ONLY LOOK LIKE WINGS

This book, however, is not about the theory of socialism as an organic system. Rather, it is about that attempt in the twentieth century to build an alternative to capitalism, an alternative that relied upon things that looked like wings and which crashed.

But, what were those things that looked like wings? For some people, the cautionary tale is all about state ownership of means of production. Accordingly, to escape the fate of Real Socialism, they argue that we must accept that private ownership of means of production is essential. For others, the tale revolves around the reliance in Real Socialism upon central planning. So, their answer is that markets are not specific to capitalism and that a viable alternative to capitalism must embrace the market.

If we are skeptical about such conclusions, though, what is our alternative explanation for the fate of Real Socialism? To select and blame a *different* element from the combination that made up Real Socialism—for example, underdeveloped capitalism, the lack of world revolution, short men with moustaches? That can be an entertaining parlor game but in the absence of a careful consideration of precisely how various elements within Real Socialism were interconnected and interacted to make up that whole, can we really understand its fate? Which were inherent, indeed necessary, aspects and which were contingent, merely historical elements?

To understand the significance of individual elements, we need to try to understand Real Socialism as a system. Even elements that correspond to what may be found in capitalism or to the concept of socialism for the twenty-first century by themselves are not sufficient to identify the nature of the system. Parts, after all, gain their significance from the particular combinations in which they exist—that is, the whole of which they are part. Even *real* wings are only parts.



## OVERTURE

## The Conductor and the Conducted

Do we need leaders? Certainly, when we work together on a common project, we are more productive than when we are separate and isolated. The whole is greater than the sum of the parts taken individually. But do we need a director in order to work together on a common project?

## A DIRECTING AUTHORITY

Within capitalist relations of production, a capitalist hires "individual, isolated" owners of labor-power, directs their cooperation and owns the products of their collective labor. As the owner of the result of their activity, he is the beneficiary of "the social productive power which arises from cooperation"; it is "a *free gift*" to that capitalist.<sup>1</sup> According to Marx, though, direction in the process of cooperation is not unique to capitalism: "All directly social or communal labour on a large-scale requires, to a greater or lesser degree, a directing authority." He offered two reasons: (a) "in order to secure a harmonious cooperation of the activities of individuals" and (b) "to perform the general functions that have their origin in the motion of the total productive organism, as distinguished from the motion of its separate organs."<sup>2</sup>



According to Marx, in short, there is a *general* necessity for the “function of direction which arises out of the nature of the communal labour process.” That general requirement, though, must not be confused with the particular content and form that it takes on within capitalism. After all, the essence of capitalist direction embodies capital’s drive to expand surplus value (thus the greatest possible exploitation of workers), the need to overcome the resistance of workers and the need to protect investments in the means of production. Accordingly, capitalist direction is inherently an *antagonistic* process, and it takes on “despotic” forms—a hierarchy of supervisors whose function is to police workers and command in the name of capital.<sup>3</sup>

But a despotic character of direction is not unique to capitalism. “In all modes of production that are based on opposition of the worker as direct producer and the proprietor of the means of production,” supervision and control of the producers is essential. Marx pointed to, for example, the supervision of slaves in the Roman Empire and also to “despotic states,” where “supervision and all-round intervention of the government” involves “the specific functions that arise from the opposition between the government and the mass of the people.”<sup>4</sup> In all such cases, direction is “twofold in content”—it is general and specific, both that aspect related to every socially combined labor process and also that specific aspect related to maintenance of the particular character of exploitation.<sup>5</sup>

Let us try, though, to separate these two aspects logically and to consider in itself the *general* side—that “work of supervision and management [that ] necessarily arises where the direct production process takes the form of a socially combined process, and does not appear simply as the isolated labour of separate producers.” According to Marx, this combined labor in itself is enough to require a “directing authority”: “where many individuals cooperate,” he noted, “the interconnection and unity of the process is necessarily represented in a governing will, and in functions that concern not the detailed work but rather the workplace and its activity as the whole, as with the conductor of an orchestra.”<sup>6</sup> In a process of cooperation, someone must have responsibility for the whole, for “the total productive organism.”



For Marx, the orchestra conductor was a symbol of directing authority that is not based upon the division between producers and the owners of the means of production. The conductor does not lead the orchestra because he owns the means of production: "A musical conductor," Marx writes, "need in no way be the owner of the instruments in his orchestra"; rather, his role as leader is the result of "the productive functions that all combined social labour assigns to particular individuals as their special work."<sup>7</sup> In short, the orchestra conductor is *necessary*. "A single violin player is his own conductor; an orchestra requires a separate one."<sup>8</sup>

The "special work" assigned to the orchestra conductor is to see the members of this orchestra as a whole rather than as a collection of separate players and to ensure that they function harmoniously and successfully as a unit in performing the predetermined score. Thus the conductor articulates the separate powers of the individual musicians into a collective power, where the whole is greater than the sum of its individual parts. But to secure that "harmonious cooperation" and to function as the agent of the whole, the conductor must be able to exercise authority over the individual members.

Does the conductor, then, have power over the members of the orchestra? For Elias Canetti, the conductor is the *embodiment* of power:

His eyes hold the whole orchestra. Every player feels that the conductor sees him personally, and still more, hears him. The voices of the instruments are opinions and convictions on which he keeps a close watch. He is omniscient, for, while the players have only their own parts in front of them, he has the whole score in his head, or on his desk. At any given moment he knows precisely what each player should be doing. His attention is everywhere at once, and it is to this that he owes a large part of his authority. He is inside the mind of every player. He knows not only what each *should* be doing, but also what he *is* doing. He is the living embodiment of law, both positive and negative. His hands decree and prohibit. His ears search out profanation.<sup>9</sup>

Truly, this is power: "Quite small movements are all he needs to wake this or that instrument to life or to silence it at will. He has the power



of life and death over the voices of the instruments; one long silent will speak again at his command." To be able to exercise that power, on the other hand, requires that the players accept those commands: "The willingness of its members to obey him makes it possible for the conductor to transform them into a unit, which he then embodies."<sup>10</sup>

In this description of the orchestra, there is no room for spontaneity or improvisation. Rather, the predetermined score must be followed. In this division of labor, each player has a precise assignment. By performing their assigned tasks with the regularity of a machine and by following the directives of the conductor, the orchestra as a whole achieves the result that exists ideally in the mind (or on the desk) of the conductor.

### THE "KEY LINK": HUMAN DEVELOPMENT AND PRACTICE

But, as we noted earlier, there is always more than one product of human activity. When we grasp the "key link" of human development and practice, we understand that every labor process inside and outside the formal process of production has as its result a *joint product*—both the change in the object of labor and the change in the laborer herself.

If this is the case, then, we always need to ask not only about the success of a labor process in achieving a particular predetermined goal but also about the nature of the human beings and capacities produced within the process. When the capacities of workers grow through their activity, this is an essential investment in human beings. Accordingly, in my book *The Socialist Alternative* I argue that "socialist accountancy" and a concept of "socialist efficiency" must incorporate explicitly the effects upon human capacities of all activities.<sup>11</sup>

Marx explored this question at length in *Capital*—by demonstrating the *negative* effect upon the capacities of workers of production under capitalist relations. He pointed out that under the direction of capital, the producers are subordinated to a plan drawn up by the capitalist, and their activity is subjected to his authority and purpose; the joint product that emerges from this particular social labor process separates thinking





and doing, and its results must be entered as negative in any accounting system that values human development.<sup>12</sup>

This is what we need to keep clearly in mind when we think about socialism. Social production organized by workers is a necessary condition for the full development of the producers; it is not something to be put off to some future society. "As long as workers are prevented from developing their capacities by combining thinking and doing in the workplace, they remain alienated and fragmented human beings whose enjoyment consists in possessing and consuming things."<sup>13</sup> Once we grasp Marx's insight into revolutionary practice, the importance of that key link of human development and practice, we recognize that the process of building socialism must be one of simultaneously producing new socialist human beings—that is, *two* products rather than one.

Return, though, to Marx's metaphor for the general necessity for a directing authority where many individuals cooperate—the orchestra conductor. Think about how that particular conductor enforces the division of labor of the players (including the separation of thinking and doing) in order for them to perform the predetermined score as a harmonious unit; and think about what he *rejects*—spontaneous creation, collective interaction among the players, jazz.

The orchestra performs the music. But what is the joint product in this process? What development of human capacities occurs in this social labor process under the direction of the orchestra conductor as described above? Certainly, this process is far more rewarding than isolated, individual activity: "When the worker co-operates in a planned way with others, he strips off the fetters of his individuality, and develops the capabilities of his species."<sup>14</sup> Certainly, too, the members of the orchestra can take pride in their collective accomplishment.

But when they are working in accordance with the plan of another who stands over and above them and are subjected to a strict division of labor, what the collective worker achieves occurs at the expense of the individual member. As in the case of the division of labor that developed in manufacture, "the knowledge, judgement and will" otherwise exercised by an individual musician is now concentrated in this relation in



the representative of the whole.<sup>15</sup> What individuals lose in this process is the opportunity to develop their own capacities by exercising their knowledge, judgment and will collectively.

Compare this to a process in which the musicians listen to each other, engage in conversation and build upon the contributions of each other. That is a process in which the whole exceeds the sum of the parts taken individually and where the capacities of the producers expand through their practice. Leadership in such cases, to a greater or lesser extent, involves general guidance and the space for initiative from below; its joint product is demonstrated by the emergence of *new* leaders.

### SERVE THE MUSIC

Do we need leaders? There is a great difference between the recognition of the importance of coordination, on the one hand, and the conclusion that leadership is “the special work” assigned to particular individuals on the other. The first flows from understanding the benefits of social cooperation and is not specific to any form of coordination. The second involves a particular division of labor—*a social relation in which the roles of conductor and conducted are fixed, and commands flow one way.*

A general process of direction of combined labor is an abstraction. Coordination always occurs “within and through a specific form of society,” and the example of the orchestra conductor identified by Marx is one form (but *only* one form) of non-capitalist direction.<sup>16</sup> To demystify the nature of capital, it was sufficient for Marx to point to the orchestra conductor to demonstrate that capitalists as such are not necessary as functionaries of production. That, however, does not mean that the relation of conductor and conducted is the appropriate form of cooperation in the society of associated producers.<sup>17</sup>

There are different forms of leadership and different goals. If people are produced through their activity within particular relations, the human products of a society divided into conductors and the conducted will be specific to that society. And how is such a society reproduced? Will those who receive commands from the conductor *always* need particular





## OVERTURE: THE CONDUCTOR AND T

individuals who have the power to direct as their “special work”? And how are those who exercise power chosen and produced?

Consider the conductor. If we are to believe Canetti, the conductor does not seek power for personal gain or for the exercise of power itself. Rather, the music is “the only thing that counts ... and no one is more convinced of this than the conductor himself.” To transform an assemblage of different people into a unit, to monitor all closely, to ensure that they all play their parts properly, to silence those who deviate from the plan—no one is more convinced than the conductor “that his business is to serve music and to interpret it faithfully.”<sup>18</sup> I am essential, he thinks—without me, there would be chaos.

Metaphors can be dangerous—they can illuminate for a moment but can never substitute for analysis.<sup>19</sup> To understand “real socialism,” we need to go beyond metaphor.







## 1—The Shortage Economy

Let us begin by identifying the object of study. Real Socialism as a concept emerged in the 1970s in the Soviet Union and Eastern Europe for the principal purpose of distinguishing the existing system there from theoretical or abstract concepts of socialism. Critiques of capitalism, it was argued, could no longer be “confined to the purely conceptual realm. They are impelled by the rich experience of countries that have successfully built (or are building) socialism.” In short, there was a developed socialism, “a really existing socialist society,” a new society that had been built as the result of real practice.<sup>1</sup>

The development of this concept of Real Socialism played several roles. Firstly, it served as a means to defend against criticism of the Soviet model by those who harkened back to Marx and Engels, those who argued the need for reforms (for example, those who looked for “socialism with a human face”) as well as those who thought they could build socialism by a different way (as in China at the time).<sup>2</sup> There was another function as well: this concept of Real Socialism allowed the Brezhnev leadership to distinguish their focus from the stress in the preceding Khrushchev period upon building communism. Real Socialism was still to be understood as a stage of history preceding communism; however, it needed to be understood as a consolidated, stable system and celebrated as such.



For our purpose, then, Real Socialism refers to the nature of the system in the Soviet Union and in the countries in Eastern and Central Europe that adopted the Soviet model in the period roughly from the 1950s through the 1980s. Thus our principal focus is upon the system which was more or less consolidated and stable rather than the original emergence of that system.<sup>3</sup>

### THE SYSTEM PARADIGM

To consider Real Socialism as a system, the appropriate starting point is with Marx—"the pioneer of the system paradigm" according to Janos Kornai, the Hungarian analyst of Real Socialism. "Researchers who think in terms of the system paradigm," Kornai proposes, "are concerned with the system as a whole, and with the relations between the whole and its parts."<sup>4</sup> That certainly was what Marx did. Considering the concept of an organic system, a "structure of society, in which all relations coexist simultaneously and support one another," Marx stressed that its elements could not be treated as "independent, autonomous neighbours" extrinsically or accidentally related; rather, they "all form the members of a totality, distinctions within a unity."<sup>5</sup>

This focus upon the whole constitutes a methodological revolution.<sup>6</sup> It breaks with the "Cartesian" heritage that views the parts as "ontologically prior to the whole; that is, the parts exist in isolation and come together to make wholes." In that Cartesian paradigm, described brilliantly by Levins and Lewontin, "the parts have intrinsic properties, which they possess in isolation and which they lend to the whole." In Marx's dialectical perspective, by contrast, the parts have *no* prior independent existence as parts. They "acquire properties by virtue of being parts of a particular whole, properties they do not have in isolation or as parts of another whole."<sup>7</sup>

In addition to situating parts within particular wholes, the system paradigm leads us to think about how systems change. "What distinguishes the thinking of those working within the system paradigm from that of their colleagues outside it," Kornai argues, "is that they are



interested in the *big* changes, in the big transformations. For instance, they enquire into what processes of decay are going on within a system, so that it will come to an end and give way to another system. They ask how there occurs a transition from one system to another system, or from one typical version of a great system to another.”<sup>8</sup>

But we also must ask, why do systems *not* change? Why did slavery last for centuries? Why did feudalism? And what keeps capitalism going? How is it that tomorrow there are capitalists and wage laborers? What makes these relations stable? In short, when you focus upon systems, you ask both what permits the reproduction of a system and also what leads to its non-reproduction.

### THE REPRODUCTION OF ECONOMIC SYSTEMS

“Whatever the social form of production process,” Marx declared at the opening of chapter 23 of volume 1 of *Capital*, “it has to be continuous; it must periodically repeat the same phases. A society can no more cease to produce than it can cease to consume. When viewed, therefore, as a connected whole, and in the constant flux of its incessant renewal, every social process of production is at the same time a process of reproduction.”<sup>9</sup>

Following that opening general statement, Marx demonstrated that his specific discussion in *Capital* had provided the basis for viewing capitalism as a system of reproduction. He underlined this point by concluding the chapter as follows:

The capitalist process of production, therefore, seen as a total, connected process, i.e. a process of reproduction, produces not only commodities, not only surplus value, but also produces and reproduces the capital-relation itself; on one hand the capitalist, on the other the wage-labourer.<sup>10</sup>

The subject, thus, was a “connected whole” constantly in the process of renewal—one that produces and reproduces material products and



social relations—which are themselves presuppositions and premises of production. “Those conditions, like these relations, are on the one hand the presuppositions of the capitalist production process, on the other its results and creations; they are both produced and reproduced by it.”<sup>11</sup> Capital in this way spontaneously produces its premises: “In the completed bourgeois system, every economic relation presupposes every other in its bourgeois economic form, and everything posited is thus also a presupposition; this is the case with every organic system.”<sup>12</sup>

But a “completed” economic system doesn’t drop from the sky. A new system emerges initially based upon historic premises, those it inherits from the previous society rather than those it produces itself, and “its development to its totality consists precisely in subordinating all elements of society to itself, or in creating out of it the organs which it still lacks.”<sup>13</sup> For capitalism to become an organic system, capital needed to alter the mode of production and to create a “specifically capitalist mode of production.” As indicated in the Introduction to this book, once that capitalist process of production is “fully developed,” capital produces the workers it needs, the presupposition of workers who look upon capital’s requirements as common sense.<sup>14</sup>

However, what ensures the reproduction of the worker as wage laborer *before* capital has “posited the mode of production corresponding to it”?<sup>15</sup> Faced with workers who do *not* look upon the requirements of capitalist production as self-evident natural laws, workers who by education, tradition, and habit still consider the sale of their labor-power as unnatural, “the rising bourgeoisie needs the power of the state.” Thus capital proceeded to subordinate all elements of society to itself through the coercive power of the state (for example, “grotesquely terroristic laws”), using this power to compel workers “into accepting the discipline necessary for the system of wage-labour.”<sup>16</sup>

Accordingly, until the development of the specifically capitalist mode of production, the reproduction of capitalist relations of production required a specifically capitalist mode of *regulation*.<sup>17</sup> This mode of regulation was needed to prevent workers from extracting themselves from their dependence upon capital and entering a “diametrically opposed” relation—one where the producer “as owner of



## THE SHORTAGE ECONOMY

his own conditions of labour, employs that labour to enrich himself instead of the capitalist.”<sup>18</sup>

In short, capitalism was not fully successful in “subordinating all elements of society to itself, or in creating out of it the organs which it still lacks” until it developed the specifically capitalist mode of production. Until the bourgeois system is “completed” as an organic system, elements are present in society that are alien to capitalist relations. Thus when we consider society at such a point, it is neither purely one system nor another. Rather, necessarily characteristic of the existing society is a *contested reproduction*—a struggle between differing productive relations, between “two diametrically opposed economic systems.”

In *The Socialist Alternative*, I proposed that the same would be true for socialism. Until the associated producers develop their own specifically socialist mode of production, one that produces a working class that “by education, habit and tradition looks upon the requirements of that mode of production as self-evident natural laws,” a socialist mode of regulation is required. Until socialism has developed upon its own foundations, the elements it inherits from the old society infect it, and the situation here too is one of “contested reproduction,” a struggle between two opposed economic systems. In short, to ensure the reproduction of socialist relations of production under these conditions, a specific mode of regulation that subordinates the elements of the old society is essential.<sup>19</sup>

We need to pose the same questions with respect to Real Socialism. How was the system reproduced? Did it succeed in developing a specific mode of production which spontaneously produced its premise? Or did it require a specific mode of regulation to ensure its reproduction?

## THE METHOD OF POLITICAL ECONOMY

How do we get to the point of being able to explore such questions? For Marx, it was clear that the starting point must be a careful study of a real society. The concrete is “the point of departure for observation and conception.” But empirical study in itself does not permit you to





grasp the system as a totality; rather, you need the theorist's instrument, "the power of abstraction."<sup>20</sup> The method of inquiry, as Marx noted, "has to appropriate the material in detail, to analyse its different forms of development and to track down their inner connection." And that appropriation of the material in detail is a *precondition* for bringing "a science to the point at which it admits of a dialectical presentation."<sup>21</sup>

This dialectical presentation, then, is precisely what Marx called the "scientifically correct method." By starting from the study of the concrete, it is possible to distill simple principles that allow you to deduce elements in a sequence determined by the nature of their relations within the society in question.<sup>22</sup> Deduction allows you to understand the interconnections within the concrete whole and thus not to treat the elements as "independent, autonomous neighbours." To proceed from those simple conceptions to a conception of the whole "as a rich totality of many determinations and relations" was how Marx constructed the concept of the organic system. Through this method, he was able to demonstrate how the later logical developments in capitalism are latent in the simple concepts.

But the starting point must be that appropriation of the concrete in detail. That is what makes Janos Kornai's examination of Real Socialism such a useful scaffold. Beginning with his initial analysis of managerial behavior and the planning system in his native Hungary during the 1950s to his subsequent in-depth study of the "shortage economy" in general, to his later synthesis of the "immanent regularities of a socialist economy," Kornai's starting point was unquestionably the concrete characteristics of Soviet-type economies.

Making his analysis more than an empirical report, however, was Kornai's conscious attempt to imitate Marx's method. Thus, just as Marx pointed to "the completed bourgeois system [where] every economic relation presupposes every other in its bourgeois economic form," Kornai concluded that the characteristics of Real Socialism "exist not merely side by side and independently but in the closest of relationships with each other."<sup>23</sup> The phenomena, he noted, "all belong together and strengthen each other. This is no loose set of separate parts; the sum of the parts make up an integral whole."<sup>24</sup> In short, Real Socialism was



definitely “a structure in which all the elements coexist simultaneously and support one another.”<sup>25</sup>

For Kornai, Real Socialism was thus an organic system—a system whose “combination of main features forms an organic whole.” It was a “coherent system,” “a coherent whole” whose elements are “organically connected and reinforce each other.” And, characteristic of that coherent totality is that “an affinity applies between the elements of it, so that they mutually complement and attract each other.” Further, corresponding to Marx’s description of the “becoming” of an organic system as consisting “precisely in subordinating all elements of society to itself, or in creating out of it the organs which it still lacks,” Kornai argued that the process of becoming Real Socialism was one in which “specific forms and institutions grow *organically* within the system.”<sup>26</sup>

That process is one in which “a natural selection of institutions and behavior patterns takes place, and ultimately enormously strengthens and greatly consolidates the inner coherence of the system.” Indeed, once the key elements are present, the completion of the system tends to occur spontaneously: “The new structure proliferates with an elemental force, propagating itself and penetrating into every social relationship. Once the start of the process is imposed upon the society, it goes on in a spontaneous manner.”<sup>27</sup> In this way, he argued, Real Socialism proceeded to produce its own premises—with the result that every economic relation presupposes every other in its “real socialist” economic form.

In short, Kornai attempted to “appropriate the material in detail, to analyse its different forms of development and to track down their inner connection.” To represent Real Socialism as an organic system, he explicitly followed Marx’s path of proceeding from simple concepts to a conception of the whole “as a rich totality of many determinations and relations.” In Kornai’s logical construction of Real Socialism, “a deductive train of thought . . . leads from a few main premises to an entire thought-network of conclusions.”<sup>28</sup>

That combination of concrete study and a serious Marx-influenced attempt to grasp the inner structure and inherent tendencies of the system makes Kornai’s work stand out among analyses of Real Socialism. However, as will be seen in this and succeeding chapters, I argue that he



is *wrong* in his understanding of Real Socialism as an organic system. In order to reach this conclusion, he effectively assumed away “contested reproduction” and, in particular, the logic of capital.

### CHRONIC SHORTAGE

Start from the concrete: the characteristics of the Soviet Union and Eastern European countries following the Soviet model from roughly the 1950s through the 1980s. We begin with an obvious surface phenomenon—chronic shortage. Shortages facing consumers, shortages facing producers—in every aspect of life in Real Socialism, there was shortage. Indeed, responding to shortages was a way of life. The consumer went to the market and could not find what she wanted, so she had several choices: she could continue to search for that product, could postpone the decision to purchase until a later time, could join a queue, or could substitute another product for the originally desired one. All of these forced adjustments to disappointed purchasing intentions were part of life under shortages.<sup>29</sup>

So, too, was hoarding, when it was possible: “It is usual to say that every member of the household is recommended to carry a shopping bag in case he finds something worth buying. If he sees a queue, he should join it just to be safe—he can ask later what is being allocated.”<sup>30</sup> Naturally, if you had more than what you needed of a particular item, there was always the possibility of trading it with someone who had what you wanted. Indeed, informal networks, personal contacts, favors for (and from) friends were means of survival within the context of shortages. In addition to the formal mechanisms, there was an informal principle of distribution: to each according to what his personal contacts can provide.<sup>31</sup>

The same patterns were true for enterprises and firms. As a seller in a seller’s market, a characteristic of the shortage economy, the firm is in a favorable situation. However, as buyer, it also faces the problems of forced adjustment: it must wait, search, queue, or engage in forced substitution. It cannot easily postpone securing inputs, though, if it is



to produce; thus “the firm, as buyer, tries to acquire as much input as possible in order that shortage should not hinder production.”<sup>32</sup> This naturally intensifies shortages of those inputs and stimulates further hoarding. Of course, those stockpiled inputs may be traded with other firms for inputs in short supply; to ensure that enterprises could get the inputs they required in order to achieve their targets, their staffs included people (the *tolkachi* or “pushers”) who could navigate well through such informal networks.

Was chronic shortage a matter of chance and contingency, of bad policies, or did it reflect something inherent in the nature of Real Socialism? According to Stalin, in his speech to the 16th Party Congress in 1930, under capitalism supply tends to outrun demand whereas in socialism demand tends to outrun supply: “In the USSR the growth of consumption (purchasing power) of the masses continually outstrips the growth of production and pushes it ahead, but under capitalism, on the other hand, the growth of consumption (purchasing power) of the masses never catches up with the growth of production and continually lags behind it, which condemns production to crises.”<sup>33</sup>

Putting aside the question as to whether this was ever an accurate depiction, what was it about Real Socialism in the period under study that generated the phenomenon of chronic shortage? Was it the planners and “the plan” that created this situation? In his early work, *Anti-Equilibrium*, Kornai proposed that there were three immediate causes of the process of shortages or “suction”: repressed inflation in trade of consumer goods, taut plans imposed upon enterprises, and the over-ambitious character of investment intentions. They all, though, could be reduced to *one* common source: “The reproduction of suction is ultimately related to impatient chasing of economic growth, the forcing of the acceleration of the growth rate.”<sup>34</sup>

This was the same basic argument he had made over a decade earlier in his *Overcentralization in Economic Administration*: shortages were attributable to the unrealistic push for growth on the part of the central authorities and, via the ensuing pressure on those authorities, inevitably reinforce “centralized administrative forms of direction of the economy.”<sup>35</sup> Accordingly, Kornai had concluded in the 1950s that shortages were not



inherent but were the result of particular *policies*, policies that could be changed. Overcentralization, overly ambitious plans and shortages were all part of “a coherent, unified mechanism, which has its own inner logic and several tendencies and regularities peculiar to itself.”<sup>36</sup> From this perspective, the remedy for the shortage economy was *decentralization*—decentralization of the economy and, in particular, decentralization of investment decisions. By moving away from centralized administrative direction of the economy, the self-reinforcing mechanism of centralization and shortages would be severed.

Of course, the begged question was why these patterns prevailed. The empirical test was soon available in the form of the decentralization carried out in Hungary. With the experience of those reforms, Kornai's position changed significantly—no, it *was not* those at the top who were the immediate cause of the shortage economy. “Even if central economic management were more moderate,” he proposed in his major study on the economics of shortage, the drive for expansion and hunger for investment would still be present.<sup>37</sup>

### THE PRINCIPLED MANAGER

Kornai's main explanation for the shortage economy became the expansion drive centered in individual enterprise managers. In particular, he emphasized the manager's “identification” with the job: “on average a firm's manager tries *to do his job properly*.” He “endeavors to secure subsistence, survival and viability of the unit put in his charge.” He wants to guarantee a smooth working process. “He wishes to avoid confusion and disorder. If only for that reason, he strives for the largest possible security: procurement of more input and larger reserves.” The manager further wants to “win his superiors' acknowledgement, avoid their anger, and to fulfill their expectations: not only their instructions but also their wishes.”<sup>38</sup>

In short, Kornai proposed that shortages *really* were due to the principled behaviour and discipline of the manager. Criticizing those who continued to stress bureaucratic dependence and the emphasis upon





growth by central authorities as the explanation of the quantity drive of firms, his earlier argument, Kornai now argued that the main explanation was the manager's identification with the job: "This general motivation is *sufficient in itself* to bring about the almost insatiable demand of the firm for inputs and, as we shall see later, an unquenchable expansion drive."<sup>39</sup>

With respect to investment itself, Kornai also explicitly retreated from his earlier view, stating now that the "growth policy of the economic leadership is a secondary explanatory factor."<sup>40</sup> "In a socialist economy," he proposed, "there is no firm or non-profit institution which does not want to invest." And again, Kornai emphasized the identification of the manager with his job as the central factor generating the expansion drive and investment hunger: "He is convinced that the activity of the unit under his charge is important. Therefore it has to grow."<sup>41</sup>

True, there were personal interests: "the leader's *power*, social prestige, and consequently his own importance grows together with the growth of his firm or nonprofit institution." However, material considerations were *secondary*. Even in their absence, the leader will "fight like a lion" for additional investment. The expansion drive, Kornai proposed, had become deeply rooted in thinking, "One *must* grow." This expansion drive was to be found at all levels of the economic hierarchy: "When it comes to the distribution of investment resources, each fights for more investment for *our* team, *our* firm, *our* ministry."<sup>42</sup>

And, it was a struggle on behalf of *our* workers. Given their identification with their own jobs and enterprises, managers also identified with their workers. Each manager *also* attempted to increase the level of wages of workers in his sphere. If, accordingly, workers attempted to increase their wages, they were not in battle against their immediate superiors: the managers "also fight for the correction of relative wages at all levels. The foreman wishes to remedy grievances on the shop floor, the firm's manager to remedy those of the firm, and the minister or his deputy wants to remedy those of the whole industry."<sup>43</sup>

Kornai thus proposed that there was a unique characteristic in these relations: management at all levels acts in wage negotiations with superior authorities "*as trade union officials and not as employers*. . . . Every manager tries to wring higher wages for his shop, section, etc., from his





superior.” This flows from the perspective of the manager: “The manager feels he is primarily responsible for solving the problems of the *part* of the system entrusted to him. He feels responsible not for the entire economy, but for a clearly specified part of it, and identifies himself with the latter.”<sup>44</sup>

There’s a rather significant problem, though, with this description of managerial motivation and behavior. It flies directly in the face of many other accounts of enterprise managers—beginning with that of Kornai himself!

### ENTERPRISE MANAGERS AS AGENTS

Consider the situation of the central economic authorities (the “planners”). In their central plan, they have broad goals for the growth of the economy over long periods of time (5 years, 15–20 years, etc.), which are specified generally (rates of growth, regional patterns, specific categories of production, etc.). And, by considering the input requirements for those goals, they attempt to identify potential obstacles and bottlenecks which could prevent realization of those plans. The shorter the time period, the more specific and targeted the goals.

Thus the annual plan specifies goals for the production of particular consumer goods and particular producer goods and assigns specific targets to enterprises. The planners try in this respect to coordinate the activity of enterprises as part of a single integrated national economic unit. They want the enterprises to meet those targets because fulfillment by each enterprise of its output target is necessary if other firms are to get their input requirements and if adequate and planned supplies of consumer goods are to be available. In other words, the success of the annual plan as a whole depends upon the success of the individual enterprises.

If we assume that the managers correspond to the description that Kornai offers, we would expect that these managers would recognize the interdependence that exists between their production targets and the success of the economy as a whole and thus they would act accordingly. The manager’s identification with the job and his principled desire to do



his job properly would be all that is necessary to ensure that the enterprise produced what the plan needed in order to ensure the coherence of the economy for a given time period.

*But this is an assumption that the planners did not make.* On the contrary, they assumed that the managers were motivated by material interest—that is, the managers acted as if they wanted to maximize their personal incomes in the present and the future. Indeed, Joseph Berliner commented at the time that “the predictability with which managers accommodate to a new bonus scheme may be compared to the fidelity with which a compass searches for the magnetic north. The manager himself is a wonderfully efficient computer program to maximize the value of any function fit into him that varies positively with income.”<sup>45</sup> To encourage the managers to produce according to the plan, the planners provided bonuses (or “*premia*”) for successful plan fulfillment.

And these bonuses were not a negligible part of the income of the managers. Berliner noted that though the bonus for Soviet enterprise managers in 1934 accounted for roughly 4 percent of their income (rising to 11 percent by 1940 in the context of attacks upon “equality-mongering”), this increased to 33 percent during the war but was driven down subsequently to 7.7 percent by 1960 as Khrushchev pushed to reduce income inequality. This de-emphasis upon bonuses was viewed as an error by those who replaced Khrushchev. According to Berliner, the average level of bonuses increased to 21.5 percent by 1966 and to 34.5 percent by 1970. Indeed, he noted one case of a well-managed enterprise (the Rostov agricultural machinery plant), where in 1966 bonuses of engineering and technical personnel represented 21.5 percent of their income and for directors and department heads, 40 to 60 percent of their income.<sup>46</sup>

Thus planners functioned on the premise that by specifying output targets (over the course of a year—for example, by month, quarter, etc.) and assigning a bonus for plan achievement, the managers would respond; this would ensure that enterprises would receive their inputs and that the stores would have the appropriate consumer goods. But how exactly was that output target specified? It *mattered*—because income-maximizing managers had discretion. In physical quantities or



value terms (in order to aggregate different products, models, sizes, etc)? And, in the former case, how were those quantities specified?

The Soviet press demonstrated regularly how specification of targets mattered—ranging from the classic cartoon showing a frame with workers carrying one gigantic nail (with the heading, “the factory fulfills its plan”) to the heavy chandeliers (denounced by Khrushchev) to the thick paper produced by the paper industry, incomplete buildings because construction enterprises were credited with more value added in the early stages of production than later, and the practice of “gold-plating” (where, for example, a clothing factory used material for a coat lining that cost twice as much as the cloth for the outside, thereby substantially increasing the value of the coats produced).<sup>47</sup>

These seemingly perverse phenomena were identified by Kornai in his classic study of light industry in Hungary in the 1950s. Giving an example of the characteristic of “turning 100 percent into a fetish,” Kornai described a leather factory whose target was expressed in value. Since the value of work in progress could be factored in, the way to get a few extra percent in the last few days was to dump large quantities of raw hides into the soaking tanks. “The net value added,” he noted, “is practically nil, but the material thrown into the dipper instantly assumes a value equal to 75 percent of that of finished leather for the purposes of reckoning total production.”<sup>48</sup>

Every effort was made to ensure that plan fulfillment reached 100 percent. Thus managers became artists in devising methods for embellishing their results: “The smart economic administrators are past masters in the art of juggling with index numbers, and merely exploit the economic ambiguities and contradictions which are contained in the system of indices to which premium payments attach.” On the same point, Kornai indicated that “it is not, in fact, possible to find a single director or other official concerned with plans who does not know how to conjure up an additional one or two percent, when really pushed to do so, in order to secure his premium—and this without any actual infringement of regulations.”<sup>49</sup>

Closely associated to the 100 percent fetish was what Kornai described as “the periodic unevenness of production”—that is, the tendency for



spurts of production and work in the last stages of the plan in order to make the quota. In the Soviet Union, the latter practice was known as “storming,” and among its effects was a significant decline in the quality of output (a reason that the common wisdom was to try to purchase something produced in the first part of the month rather than after the middle of the month). There were constant complaints about the quality of output—for example, the vacuum cleaners that electrocuted you, which were mentioned in a Soviet newspaper of September 1985.<sup>50</sup> This problem was familiar and long-standing: the planning chairman in Czechoslovakia stated in 1951 that “storming is one of the most wasteful and costly ways of meeting the plan. It leads to unused equipment and manpower, to unused capacity, to waste of materials, to an increased number of rejects and to an uneconomical increase of wages by overtime pay.”<sup>51</sup>

In short, the managers did everything possible to secure their bonuses. What could prevent this? A shortage of materials? The answer to that was to stockpile inputs and hoard materials. Difficulties in getting enough materials at key points? The answer was to produce it yourself. Or, do favors, bribe officials, or make alliances to make certain you got them. Shortages of workers on hand for the periods of storming? Stockpile and hoard workers.

But what happens, despite all these efforts, if the enterprise is still not close to its target? What happens if it is more like 10 percent away? What about the 100 percent fetish then? Kornai answered that what developed was “the psychology of losing hope.” The managers would give up the struggle: “From a financial point of view (though not, of course, from a moral one) it is a matter of complete indifference to top management whether the degree to which they fulfill their indices amounts to 99 or 91 percent.”<sup>52</sup>

Another reason for giving up the struggle in the short term was to save the potential output for the *next* plan period. Indeed, another category of problem identified by Kornai was the “conflict between today and tomorrow.” Obviously the rush at the end of every month, that process of storming, could lead to shortages in the beginning of the next period—because of the exhaustion of input stocks and workers (producing, thus, the unevenness of production). A longer-term concern,



though, was the effect of this process upon the development of new manufacturing techniques, improved quality of products, maintenance of equipment, training apprentices and skilled personnel. All of these affect future performance; however, emphasis upon them could interfere with meeting the *current* plan: "Timely work on maintenance may require the stopping of machines, the continued working of which could assist very materially with fulfillment of a monthly plan."<sup>53</sup>

Although Kornai did acknowledge that linking bonuses to plan fulfillment encouraged significant output increases, there was one aspect of this focus upon material incentives that clearly affected the quality of planning. Obviously, the probability of securing a bonus for plan fulfillment was greater, the lower the plan. "If the plan is loosely drawn up," he indicated, "this naturally eases the task of filling it, of obtaining the premium in respect of it, and of winning moral approval. Top management of enterprises thus have a direct personal interest in being given a loose plan to fulfill."

Accordingly, there was a systemic tendency to attempt to keep the plan targets low—to "withhold information concerning the potentialities and the reserves of their enterprises from the authorities."<sup>54</sup> The response of enterprise managers to the demands from the top, according to the Czechoslovakian economist and reformer Ota Šik, in 1968, was to adopt "the most obvious mode of defense: they understated their potentialities and overstated their needs. . . . And there evolved a mechanism for deception on a grand scale, of not showing one's hand, and this was the only sphere in which people's initiative could really develop to the full."<sup>55</sup>

Alec Nove described the pattern in the following way:

Information flows are *bound* to be affected, distorted, by the interests of the information-providers, who are in effect competitors for limited resources. . . . But to expect unbiased information from those interested in the results to which the information is put is to live in cloud-cuckoo land.<sup>56</sup>

*In other words, false information flowed upward.* Here was the dilemma: good planning depends on accurate information. But that was





not available because it was not in the economic interests of the managers to send accurate information upward. Šik commented that “the consequence is that Czechoslovak economy lost its last asset—objective information about needs, reserves and potentialities.”<sup>57</sup>

Of course, the planners and officials in the ministries knew this was happening. They knew that firms were concealing information—in other words, that the quality of the information sent upward by enterprises was biased in favor of those enterprises. So they responded in a logical manner: they emphasized the necessity for taut plans in order to mobilize the hidden supplies of inputs; they argued that the enterprises were inventing “bogus difficulties.” Enterprise managers and the planners thus were engaged in constant struggle over how tight or loose the plan would be. Given the orientation of the planners for growth, then, it was all so predictable that if the enterprise did demonstrate that it could produce very well, next year’s plan would be higher. In other words, the results of any year’s production would be incorporated into the next year’s plan.

Naturally, that increase would make next year’s plan more difficult to fulfill—and, more important, next year’s bonuses more difficult to earn. So, the obvious behavior on the part of the enterprise manager was—do not overfulfill by too much. Maurice Dobb cited a Russian saying: “A wise director fulfills his planned 105 percent but never 125 percent.”<sup>58</sup> Kornai had described the same phenomenon: “It is interesting to note that the chiefs of planning departments of enterprises become veritably frightened of the approach of the end of a quarter if they see that results will probably overshoot by too much.”<sup>59</sup>

Naturally, the managers were able to find ways to keep output figures down as well as up—for example, to keep output from being counted as finished products. Kornai concluded that “in a word, present planning and incentive systems have evoked a spontaneous tendency, the effect of which is to induce managements of enterprises to loosen plans, to hide production potentials, and to hold back outstanding production achievements. This is highly dangerous and harmful.”<sup>60</sup> In short, the clear picture that Kornai provided in the 1950s was that the behavior of the enterprise managers was contrary to the interests of society.





But not due to the shortcomings of *managers*! Rather, Kornai insisted, the problems were inherent in the existing system of economic administration and supervision of production results. These were necessary tendencies—but not necessary consequences of a planned economy *as such*. On the contrary, “They are necessary consequences of present methods of administering the economy, that is, of our present economic mechanism.” Thus Kornai argued that it was the particular combination of instructions and incentives that generated these perverse results. Indeed, a chapter subhead told the story: “Some useful and harmful tendencies which result from the joint effects of plan instructions and incentives.”

The problem was that managers were faced with a conflict between their economic interests and their sense of responsibility to the total economy; and “it is only human, if individual economic interest proves to be stronger.”<sup>61</sup> The problem, Kornai stated, was the economic mechanism—the system of financial incentives was all wrong. The existing economic mechanism had to be changed—but it could not be changed as long as economic policy continued to insist upon “overambitious and unrealistic” targets.<sup>62</sup>

The problem, indeed, was signaled by the title of that 1959 book, *Overcentralization in Economic Administration*. That argument, though, was that overcentralization was the product of “excessively ambitious policies of industrialization,” which themselves generated shortages (and thus a self-reinforcing process). If there were a lower pace of industrialization, then it would be possible for “an economic mechanism to develop in which enterprises have much more independence.”<sup>63</sup>

So, what was his 1959 solution? Lower the targets for growth, decentralize, and unleash the enterprise. The enterprise, which was “the basic unit, the ‘cell’ of the economy,” was given too many vertical instructions to carry out and had only minimal ability to engage in horizontal transactions with other enterprises.<sup>64</sup> And, even though his explanation for shortages in the 1970s (as we have seen) subsequently changed and stressed the expansion drive of the enterprise managers, *his solution remained essentially the same—give the enterprise managers more independence!*



It was not, after all, the particular behavior of those principled enterprise managers (who identified with their jobs and wanted to do good) that was the real source of the problem. Rather, the problem began at the top. Here we have Kornai's famous explanation: the expansion drive and investment hunger of the firms were only operative because the firms had "*soft budget constraints*." The traditional socialist firm knew that, faced with losses, it would be "helped out somehow."<sup>65</sup> "Its permanent survival is guaranteed even in the case of a lasting financial deficit"; accordingly, only its resources constrain it.<sup>66</sup> The soft budget constraint, Kornai argued, uniquely characterizes the socialist firm and determines its expectations and particular behavior. The soft budget constraint, he declared, is a "sufficient cause" of investment hunger in the socialist economy.<sup>67</sup>

Once again, this pointed the responsibility for the reproduction of shortages directly *back* at the central authorities, for it is they who *soften* the budget constraints of the firms. Why? Kornai answered: "paternalism." Making an explicit analogy to the economic relationship between parent and child, he noted that "the central authorities take responsibility for the economic situation" and wish to "shape the course of economic life." Reinforcing paternalism from below on the part of the managers, too, is the simple fact that "paternalism means absolute protection and safety." Paternalism, Kornai concluded, "is the direct explanation for the softening of the budget constraint"—it entails "the almost-insatiable demand for labour and the tendency to hoard it, the almost-insatiable hunger for investment, and so on."<sup>68</sup>

So, although Kornai identified enterprise managers as the ones who were engaging directly in activities which had significant negative effects, the blame was to be found in the central authorities who created the incentives and the environment in which it was "only human" that the enterprise managers would act this way. Of course, the begged question (explored in the next chapter) is, *Why would the planners choose to follow policies that produced such negative effects?*





## 2—The Social Contract

A useful way to explore the interaction between planners and managers in Real Socialism is to consider it as a principal-agent problem.<sup>1</sup> In that framework, we assume the existence of a dominant party, a principal, who has a particular goal he wishes to achieve. And this principal must rely upon another party—the agent, who has his own goals, goals that differ from those of the principal. In other words, we begin by acknowledging that the interests of the principal and the agent are not identical. It is also presumed that the agent knows something the principal does not know (the problem of asymmetric information) and that it is difficult and costly for the principal to acquire that information. Accordingly, the principal-agent problem revolves around the mechanisms the principal uses to get the agent to act in accordance with the goal of the principal.

In the interaction we have described between planners and enterprise managers, it is customary to view the planner as the principal who attempts to induce the enterprise manager (the agent) to produce in accordance with the plan by providing material incentives in the form of bonuses for plan fulfillment. Certainly, as we see, the managers responded like that “wonderfully efficient computer program” to maximize their present and future income that Berliner described. Why, then, were the results so bad? Was this what the principal *wanted*?



## ENTERPRISE MANAGERS AS PRINCIPALS

In the principal-agent model, it is assumed that the principal knows what the agent wants (that is, his utility function) and therefore creates the conditions that will produce the desired results. In this particular case, the premise is that the planner, though lacking the detailed knowledge necessary for planning, knows that the managers respond to material incentives and accordingly sets bonuses properly. So, if bonuses were primarily for short-run output plan fulfillment, we may presume that is because planners want to maximize output in the short run.

And yet it is clear that the planners were not happy with the results they were getting. All the stories about poor goods produced and perversities were attacks on the behavior of enterprise managers, attacks led and orchestrated by those at the top. It is no accident, for example, that the Soviet press was filled with such material. So what is the explanation if the planners were not getting the real results they wanted? Was it that they didn't know enough to introduce the proper incentive schemes?

By the time he wrote *The Socialist System*, Kornai had moved away from what he called naïve reformism to oppose socialism in any form. Now he explicitly rejected the argument that the principal-agent framework (which was a good fit for his own old argument) was appropriate to describe Real Socialism and that a reform of the economic mechanism could solve the problem. "Some observers and critics of the socialist economy," he commented, "tend to ask why a better information and incentive system is not introduced under socialism. They think society can be perceived as the realization of a gigantic 'principal-agent' model." From that perspective, the leaders must be assumed to have been stupid not to have found the right information and incentive scheme. But the leaders were *not* stupid—in fact, Kornai argued, the nature of the system was so coherent that it could not be altered by applying a few such ideas for reorganization.<sup>2</sup>

So, what was the problem? Before assuming that this was indeed a principal-agent problem—one to be settled by adopting the correct incentive scheme by planners—we need to ask if we have identified the actors correctly. *Maybe the managers knew the planners' goals better*



than the planners knew the managers' goals. Maybe the managers were engaged in certain activities to induce the planners to select those mechanisms that were optimal for the *manager*.

*In fact, this reversal is implicit in the concept of the soft budget constraint.* It is the recognition by managers that the planners will not permit them to fail that leads the managers to act in particular ways. Though Kornai does not explore its implications, this is really the hidden subtext in Kornai's concept—that the managers' knowledge of planners' behavior permits the former to pursue (for whatever reason) their almost insatiable hunger to expand and that this creates the many problems generated by the resulting shortages. This inference can be supplemented by explicit examples of how actions initiated by enterprise managers generated significant dysfunctions in Real Socialism and created problems for the planners.

For example, Tamas Bauer argued that investment cycles, rather than being due to the unreasonable investment and expansion goals of those at the top, were generated from below. Enterprise managers had particular techniques for advancing their claims upon additional investment funds.<sup>3</sup> Given that the planners want to control the stock of investment projects in progress directly, he argued, "the claimants will find a way to break through it for hiding their claims (neglecting the necessary additional investments in the submitted plan proposals, etc.) or through underestimating investment costs." By starting an investment project with an artificially low amount of investment outlays in the first year, an enterprise could succeed in "hooking onto the plan" because the planners were primarily concerned at any given point with the annual investment outlays. The problem was that those at the top did not have good enough information to monitor and check this.

Thus, even if the planners wanted a feasible and harmonious investment plan, they would still be subject to strains from below. Bauer traces an investment cycle that begins with many new investment projects put in motion simultaneously. In the second phase, as the true extent of the projects under way emerges, growing investment outlays exceed significantly the planned investment; and a third phase occurs in which resulting shortages lead the central planners to put a check on





the approval of new investment projects and try to speed up completion of existing projects—moving ultimately to the postponement and suspension of lower-priority investments and a lower approval of new investments. Once the shortages abate, however, there is growing pressure to complete the postponed and suspended projects and to increase the approval of proposals—and the cycle begins again.

Here, then, was Bauer's explanation for prolonged construction periods and delays in completions, the lower efficiency of investment, lower growth rates, and a slower introduction of new technology. Was this pattern *inherent* in a planned economy? Not according to Bauer. Rather, he argued that the pattern reflected the particular relations within the economy: (a) the enterprise managers wanted investment funds because it made plan fulfillment easier and a larger enterprise increased their power status, and (b) enterprise managers knew that supervising bodies would agree to support their investment claims if the managers accepted the proposed quotas.

We come back, then, to Kornai's dismissal of the principal-agent framework as an explanation of the many perversities of the existing economic mechanism. Kornai's point is that those at the top were not stupid. So, were they *powerless*? Certainly, the managers were far from being passive agents of the planners; rather, they constantly acted to take advantage of "the ambiguities and blind spots of command planning to promote their particular interests at the expense of overall economic development."<sup>4</sup>

Drawing upon his study of the literature of East European economists, Flaherty points out that enterprise managers went well beyond the familiar defense mechanisms such as "the concealment of full production capacity from the central authorities coupled with the deliberate inflation or distortion of production reports." Individual and uncoordinated defense mechanisms, he argued, were "superseded by far more significant collective offensive strategies. These concerted responses originate in the attempts of production subunits to procure organizational allies."<sup>5</sup>

Flaherty also proposed that lobbies and sectoral coalitions, which became powers unto themselves, proceeded to usurp the authority of the "nominally sovereign central agencies."<sup>6</sup> The result was that, in the struggle for investment funds, the pattern of investment became "almost



entirely a function of sectoral dominance or the heavily skewed correlation of forces existing between the contenders in plan-bargaining.”<sup>77</sup> Entrenched forces, particularly in heavy industry, trumped everything. And, the cost, some argued, was the absence of a coherent national industrial policy.

“In light of the destructive effects of sectoral dominance,” Flaherty asked, “the obvious question becomes: why does the state not diagnose the obvious cause of these trends and take appropriate countermeasures to reassert its control against the monopolies?”<sup>78</sup> His answer is that it *tried*—by attempting to introduce additional regulations and planning indicators to resolve the problems; however, this simply triggered “redoubled efforts of lower-level production managers to evade the external scrutiny.” The central authority was “increasingly incapacitated.”<sup>79</sup>

Consider the apparent difficulty of shifting away from an extensive growth model based upon building new factories and filling them with a labor force drawn mainly from the countryside. Though this was the historic pattern of industrialization in Real Socialism, in the period under consideration the need to shift toward increasing productivity in existing production facilities was apparent. Ota Šik pointed out in Czechoslovakia that building new factories based upon resources siphoned off from existing enterprises came at the cost of modernizing existing plant and (because of the disproportionate focus upon heavy industry) satisfying consumer needs. The Czechoslovakian economy, he insisted in 1968, needed to “shift its emphasis in a relatively short period from long-term investment in heavy industry to the sectors that have suffered years of neglect.”<sup>80</sup> Similarly, Kosygin received a major report in 1967 detailing serious problems in the Soviet economy, and in 1970 Gosplan issued a grim report critical of the direction of the economy and indicating that “all basic indicators will decelerate, deteriorate or stagnate.”<sup>81</sup>

*And, yet, nothing seemed to change.* Speaking to the 27th Party Congress on February 25, 1986, Gorbachev stated that during the period of stagnation (the code word for the Brezhnev period) “we failed to apprehend the acute and urgent need for converting the economy to intensive methods of development.” Rather, there had been continued development “largely on an extensive basis, with sights set on drawing



additional labor and material resources into production.” But why? Why did they not seem to be able to make the shift to intensive development?

Flaherty’s sources offered one explanation. They argued that the inability to shift from the extensive development model to intensive development reflected in large part the power of the sectoral groups centered in heavy industry (both the enterprises and ministries). In Poland, the heavy industry and mining lobbies combined against reallocation of investment and thus continued to siphon off the bulk of new investments. Similarly, Brezhnev’s attempt to move the Soviet economy slowly to an intensive growth pattern failed and demonstrated what was described as the center’s “impotence before its subordinates” as sectoral coalitions succeeded in commandeering funds from weaker branches.<sup>12</sup>

#### CONSTRAINTS UPON THE PLANNERS

So, what was the basis of the “impotence” of those at the top? The power of the central authorities, Kornai stressed, is not absolute: “The ‘politician’ is not the external manipulator of a machine who can push buttons and turn levers at will.” Rather, he “reacts with definite action to definite signals.”<sup>13</sup> What determines those reactions?

In Kornai’s macroeconomic model of the shortage economy, he introduced not only a “real sphere” that describes production, investment, consumption, etc. (standard aspects of an economic model), but also, significantly, a “control sphere” that represents the behavior of various decision makers.<sup>14</sup> Economic policy and decision patterns were modeled as endogenous to the system; and it is in this control sphere (through those definite reactions to definite signals) that the unique and specific characteristics of the socialist economy are generated.

At the core of this model is the question of *feedback*. Kornai’s model describes not only the tendency for chronic shortage but also includes important feedback mechanisms that tend to reproduce a “normal” degree of shortage. Thus, where developments in the real sphere generate results that deviate from existing norms—the result of “habit, convention, tacit or legally supported social acceptance, or conformity”—the



system generates signals that are fed back into the system via the control sphere. Very simply, deviations from the norms produce typical reactions, predictable behavior on the part of decision makers.<sup>15</sup>

This brings us, then, to the constraints upon the planners—that is, to their apparent powerlessness. What precisely occurred in that control sphere when norms were violated . . . and why? Take, for example, the normal rate of growth of real consumption per head. Kornai argued that this was a critical norm that central decision makers honored. Looking back over ten to fifteen years, he reported that many Hungarian planners viewed the “lower limit of tolerance” for this growth rate as 2 percent and the normal rate as 3–4 percent.<sup>16</sup> Deviations from this norm, he stressed, created a feedback mechanism: “If the growth of consumption remains below its normal rate, the scale of investment will be reduced so as to leave more of the national income for consumption.”<sup>17</sup> But *why*?

What precisely produced the “control mechanism” that pushed the system back to the norm if it deviated? *A negative response by the underlying population*, according to Kornai. “Holding back increases in living standards, or their absolute reduction, and infringing the lower limit . . . sooner or later entails serious political and social consequences, tension and even shocks, which after a shorter or longer lag force a correction.”<sup>18</sup>

Those at the top, he thus stressed, were limited. The barrier “depends on the actual socio-political situation, what level and growth rate of consumption the population is content to accept, and where dissatisfaction begins. And, if there is dissatisfaction, at what point it starts to endanger the stability of the system. It is a historical fact that unrest may be so great that it induces leaders to change economic policy.”<sup>19</sup> In short, the growing consumption aspirations of the underlying population, he argued, were one element affecting the typical behavior of the central authorities; these aspirations could not be ignored.<sup>20</sup>

Closely associated with the desire of the population for rising income (along with the attendant constraint upon the planners) was their concern for stable prices. The potential for “irrationality,” Kornai proposed, in this case was high. Although at one point prices might have been set appropriately (for example, reflecting old relative costs or permitting satisfaction of basic needs), relative costs and social preferences changed



considerably over time. (Why, Kornai asked, should state subsidies for basic necessities, which encourage “overeating,” be in the social interest?) The problem was that “rigidity and inertia prevent relative consumer prices from adjusting to new conditions.”<sup>21</sup> Who, though, was rigid or conservative?

The people themselves. The issue, simply, was that movements in consumer prices were a “delicate political problem.” The household budget constraint is hard; thus every price increase hits it hard, generating grumbling and protesting. “Precisely because a rather high degree of price stability is one of the greatest achievements of socialist economies, the population *expects* prices to remain unchanged; *stability in itself is of value to people*.”<sup>22</sup> And so, this expectation on the part of the underlying population generated price rigidity. Any significant change in prices would have a major redistributive effect (as in the case, for example, of ending subsidized rents). “Any radical redistribution would upset public opinion. Those who gain by it may not even recognize their gain.” This, Kornai explained, was the phenomenon of the “trap of price stability”: “People get used to stability, and after a time they even expect the government to guarantee it. Any important price increase gives rise to unrest.”<sup>23</sup>

It was, in short, the underlying population *itself* that was characterized by “rigidity and inertia.” Not surprisingly, people were conservative in relation to measures that threatened their real incomes. Should the planners undertake an initiative in the direction of greater economic “rationality,” they were directly pitted against habit and convention (that is, against popular acceptance of the existing norms).

*The most significant norm, though, was the full employment norm.* Kornai pointed out that “one of the basic historically important achievements of the socialist economy is full employment. Not only does it reach a high level of employment but, once having reached it, firmly guarantees it.”<sup>24</sup> Unlike capitalism, with its buyers’ market for labor in which market burdens (such as search, waiting, queuing and forced substitution) all fall upon the sellers, Kornai emphasized that socialism is marked by a sellers’ market for labor—thus a high participation rate, absorption of potential reserves, and the elimination of chronic unemployment.





Accordingly, the “defenceless” feeling of workers in capitalism, which results from the threat of unemployment, is absent with the sellers’ market in labor characteristic of socialism: “The person used to employment has no unemployed competitors in the market, nor is there any possible competition from a huge potential reserve army. *The behaviour of the group used to employment is characterized by guaranteed employment.*”<sup>25</sup>

So, was this a significant constraint upon the planners? To the extent that full employment was an expectation on the part of the population, would the violation of this norm produce “serious political and social consequences, tension and even shocks”? We need to understand more about the dimensions of this employment norm if we are to assume that it did indeed compel the planners to follow a particular course.

### JOB RIGHTS

In 1975, David Granick argued that the right to a job in the Soviet Union involved far more than full employment at the macro level—it also functioned at the micro level. “It is considered impermissible, except in very rare circumstances,” he indicated, “to dismiss workers on any grounds other than those of gross incompetence or continued violation of factory discipline.” In short, “workers have had virtually complete job security. More than anything else, it is this feature which has given content in the mind of the ordinary worker to the slogan of a workers’ state.”<sup>26</sup>

The “political unacceptability of dismissals” thus gave workers real security; they were “protected, not only against the reality of unemployment, but also against the need to change either occupation or place of work under the threat of unemployment.”<sup>27</sup> This characteristic, which Granick called the “micro-economic full employment” constraint (but which he would later call “job rights”), meant that workers were “virtually immune from pressure to undergo job changes which they personally regard, for whatever reason, as reducing their individual welfare.”

Yet what was positive for workers registered as essentially negative for Kornai. His discussion of the employment norm clearly demonstrates (if there were ever any doubt) that his concept of rationality reflected





all along the perspective of the enterprise manager (the “cell” of the economy). In the absence of external slack in the labor market, that is, in this sellers’ market for labor, Kornai argued, the buyer (the manager) bears the costs of search, information collection, waiting, etc.<sup>28</sup> Further, under these conditions of shortage, firms are compelled to hoard and reserve labor for the future. From this perspective alone, “adjustment” of the employment norm was justified—a little slack in the labor market (a reserve army of the unemployed) would be rational.

The greater problem for Kornai, though, was “internal slack”—“unemployment on the job.” Kornai proposed that “the more frequent and intensive the labor shortage, the greater will be the internal slack, namely the unemployment on the job.” Why? Because “chronic and intensive labour shortage loosens workshop discipline, deteriorates work quality, lessens workers’ diligence.” He noted that “most people . . . do their work reasonably well without external pressure to do so. And the more they understand the social importance of their work, the truer is this statement.” But “*the factors operating in favour of discipline, diligence, and care are counteracted by chronic labour shortage*. The worker’s absolute security, the unconditional guarantee of employment, encourages irresponsibility in anyone susceptible to it.”<sup>29</sup>

And what could the managers do about this? Managers (including foremen) were restricted in imposing discipline; they were forced by the sellers’ market “to be indulgent.” The causal chain: the greater the intensity of labor shortage, the more frequently workers unexpectedly leave jobs to take others (with the positions remaining unfilled). “Alternatively, they may not leave, but simply be absent without justification, or they come to work, but instead of working properly just waste time.”<sup>30</sup> Few things, clearly, were worse in Kornai’s eyes than the typical behavior of workers in this shortage economy.

Obviously, functioning in this sellers’ market for labor was a problem for enterprise managers. The other side, of course, is that the shortage economy and the full employment norm provided immediate benefits for workers. But what about the central economic authorities, the planners? Did Kornai explain that the full employment norm (like the other norms) constrained the planners, compelling the decisions that reproduced



the shortage economy? In fact, he said surprisingly little about this. As Granick commented about Kornai's *Anti-Equilibrium*, "There is nothing in his treatment either of the history or of the logic of suction to suggest any role at all for the job-maintenance constraint which I consider fundamental."<sup>31</sup> And once Kornai shifted his explanation of shortages to stress the insatiable investment hunger of managers, any direct link in his analysis between the full employment norm and planners' behavior became even more obscure.

Nevertheless, given that "in Kornai's model little or nothing is invested without the approval of the Center," adaptation of the plan to the investment hunger of the managers is "a necessary condition for the investment strains that lead to labor shortage." Since "it is only the yielding by the Center to requests that causes labor demand for future periods to be unconstrained," Kornai's theory begged that critical question—why did the center agree?<sup>32</sup>

To try to answer this question, we need to know more about this employment norm. It appears to have had (at least) three relevant aspects: (a) economic pressures that create the sellers' market for labor, thereby ensuring a high probability that jobs are available for everyone; (b) political and legal pressures to place people in jobs; and (c) political and legal pressures to protect people from losing their jobs or being compelled to change them in some way. Obviously, these are related; however, if we consider only the first of these (full employment), we are likely to misunderstand their underlying basis.

Let us begin with the last of these—job rights, "the worker's *absolute security*," the de facto right of the individual worker to his existing job. This job right was supported explicitly in the labor legislation introduced in the post-Stalin period. Article 17 of the Fundamental Labor Legislation of the USSR (1971), for example, restricted the basis for dismissal of a worker to specific grounds and noted that even these grounds were valid only "if it is impossible to transfer the employee concerned to another job with his consent."<sup>33</sup>

In theory, a worker could be dismissed for violating labor discipline (for example, absenteeism and drunkenness on the job), for being unwilling or unable to perform their existing tasks, and for redundancy (i.e.,



because they were unneeded). In practice, however, it was not so easy. The first line of defense of the worker was the elected workplace trade union committee. Before any dismissal, that committee had to agree; and this had to occur at a full meeting, would require a two-thirds quorum and an absolute majority voting for dismissal.<sup>34</sup> And that decision, if it favored the worker, could not be overturned (a power that Granick described as “truly striking” because of the usual principle in Real Socialism whereby “a hierarchically higher body can always overturn the decision of a lower one.”)

Assuming the trade union committee supported dismissal, however, the worker could always turn to the courts. Lewin indicates that “in 1965, in 60% of the cases brought before them, tribunals had ordered the reinstatement of sacked workers”—with back pay, which meant “serious costs” for the government.<sup>35</sup>

Workers were also protected from job changes and transfers to other work—even in clear cases where they were made redundant by technological changes and reorganization. In such cases, most workers whose job had disappeared were retrained in the same enterprise. If they refused, however, they again had resort to the trade union for protection and to the courts (and they were even more successful here). All this happened in a context where there was a constant effort to find jobs for new entrants to the labor market—for example, pressure on enterprises to hire young people. The existence of unemployment in specific areas brought with it as well pressure by local party committees that all local enterprises add to their workforce. This was a practice supported by Article 9 of the Labor Legislation, which stated that “unfounded refusal to grant a job is prohibited by law.”<sup>36</sup>

The protection that individual workers had for their jobs from trade unions and the legal systems was real. However, as Lewin notes about the USSR, “employees possessed a more effective weapon than resort to the courts: they could defend their interests by changing jobs.”<sup>37</sup> In short, the existence of suction and the shortage economy meant that workers could ensure their rights within the workplace (including the right to a workday with a pace that was decidedly not intense—another norm). In this sellers’ market for labor, workers were able to move freely—and they



## THE SOCIAL CONTRACT

took advantage of that opportunity. Thirty percent of the Soviet industrial manual labor force left its existing enterprise in a given year—despite the measures that enterprise managers developed to retain their workers, such as upward job classification, provision of housing, childcare, etc.<sup>38</sup>

How important, then, was this combination of job rights and the shortage economy for understanding Real Socialism? Granick argued that the condition of “Job-Rights-Overfull-Employment” (JROE) took “precedence over most other objectives of central planners in the Soviet Union.” One might see it, he proposed, as a key goal of central planners that “must be satisfied fully before other objectives are pursued.” The alternative argument, he acknowledged, is that JROE was a *constraint* facing central planners, imposed upon them “against their will.”<sup>39</sup>

Which was it? Granick insisted that ensuring job rights was the preferred policy of the Soviet leaders—whether it was because they themselves preferred it or because they “believe that the political reactions of the Soviet population to violations . . . would be so severe.”<sup>40</sup> The latter was the same point he had made earlier about Hungarian reforms: “meddling with this fundamental right of Hungarian workers would raise in the sharpest form the issue of the abandonment of socialism: in the minds both of the population of Hungary and of leaders in the other CMEA countries.”<sup>41</sup> In any event, he argued that the economic result would be the same whether the typical behavior of planners occurred because these norms were their own or because failure to honor them would start “to endanger the stability of the system.”

Given that maintenance of these norms, however, was subsequently abandoned by those at the top, it is important to ascertain if planners and workers had identical goals. Consider, for example, the distinction between full employment (the right to a job in general) and job rights (the right to a particular job—what Granick called the micro-economic full employment constraint). Speaking to a group of workers, Janos Kadar, prime minister of Hungary, argued that “full employment is our system’s achievement.” However, “at the same time the rational regrouping of labor is unavoidable. The development and expansion of economical production, the contraction and finally cessation of uneconomical production require the appropriate regrouping of labor.”



What did this reveal? Ed Hewitt's interpretation was that by 1981 the Hungarian party and government leaders were at the point that "they define full employment as the guaranteed right to a job, but not to a particular job, nor to a particular way of doing that job." And that meant that "in the next few years they shall try to convince the population" of the need to regroup workers. Here were "two very formidable stumbling blocks to further economic reform in Hungary. The population is convinced that a fair income distribution is a flat one, and they are convinced that the party's guarantee of a job means that each person can keep the job he or she has right now."<sup>42</sup> Those at the top, in short, were clearly constrained by what workers considered their entitlement.

But this brings us to what some would consider a paradox of Real Socialism. Consider the phenomenon of job rights—the package that included security of employment, a relatively leisurely pace of work, and the availability of alternative jobs because of full employment. These were characteristics that would be recognized as great achievements as the results of workers' struggles in capitalism. *But they were not achievements of workers in Real Socialism—the working class and working-class organizations were not strong enough to ensure them and to protect them.*

Here was the paradox of the situation of workers in the Soviet Union as summarized by Linda J. Cook:

Its working class was until recently politically quiescent and organizationally weak, denied rights to form independent trade unions, to organize political parties, indeed to engage in effective or meaningful political participation. Yet Soviet workers seem to have gotten from post-war regimes major policy goals—full and secure employment, rising real incomes, and socialized human services—which have remained inaccessible to the best organized labor organizations in the industrialized world. How can we explain this paradox?<sup>43</sup>

What was the organizational representation of workers? As we have seen, the official trade unions protected the rights of individual workers; however, their leaders were nominated from above and their principal function was to serve as a transmission belt to mobilize workers in support





## THE SOCIAL CONTRACT

of state goals. Article 96 of the Fundamental Labor Legislation noted that the trade union organizations participated in the drawing up of state economic development plans (at the top) and “they enlist the factory workers and office employees in the management of production; they organize socialist emulation, mass-scale participation in promoting new ideas in technology, and help to promote production and labor discipline.”<sup>44</sup>

However, not a word about workers’ *power* within the workplace—not unless (as Article 97 notes) their right to take part in discussions and to “submit proposals on improving the work of enterprises, institutions and organizations” is interpreted as power. And not unless it is seen as an achievement of workers that “the officials of enterprises, institutions, organizations must promptly consider proposals and criticism made by the factory workers and office employees, and inform them regarding the steps taken on these matters.”<sup>45</sup> In other words, the company will be happy to receive suggestions from workers—and the company will decide which ones, if any, it will follow.

*No power within the workplace to direct the process of production, no ability for workers to transform themselves in the course of transforming things, but protection of individual job rights (especially against initiatives of enterprise managers).* The picture is one of an atomized yet secure workforce, a situation “where the atomized, alienated worker, deprived of any and all means of exerting collective defence of her or his interests within production and society at large, could and did assert substantial individual control over the organization and execution of work.” And its result was “slow work, defence of inefficient work organization, toleration, if not exacerbation of disruptions to the work regime, and a general disregard for quality.”<sup>46</sup> Was this result what workers wanted? Was it what planners wanted?

## THE NATURE OF THE SOCIAL CONTRACT

According to Lewin, the witty remark, “You pretend to pay us and we pretend to work,” contained “a grain of truth—i.e., the existence of a tacit social contract, never signed or ratified, whereby the relevant parties





arrived at an understanding about running a low-intensity, low-productivity economy."<sup>47</sup> Yet the social contract identified above went well beyond this; it involved not only job rights, but also rising income, subsidized necessities, and relative egalitarianism—all in return for acceptance of the power of the state and party and restrictions on any power from below.<sup>48</sup>

Did this contract deliver to workers what they really wanted or was it the best they could get under the circumstances? Cook proposed that "what the Soviet state delivered was precisely what its society most valued, that is, that party and people shared a conception of distributive and social justice that gave central place to material welfare and egalitarianism."<sup>49</sup>

*Given the absence of a mechanism by which workers could express what they wanted, however, how could we know this?* Certainly, it would be important to know what happened to workers who concluded that the terms of the contract were just not good enough. Flaherty noted, for example, reprisals against individual Soviet workers who challenged conditions in their workplaces and commented: "The corporatist *status quo* of the Brezhnevian social contract is the balance between the most that the dominant class will concede and the best that the subaltern class can expect, given the 'mercilessness of life' in a modern industrial society."<sup>50</sup>

In short, though this social contract provided definite benefits for workers, it should not be assumed that its conditions were those negotiated by workers or indeed their choice. "There was a system of mutual obligations," Boris Kagarlitsky explained:

We use the term "obligatory social contract" or asymmetrical social contract, meaning that the population was forced into this social contract. The social contract was definitely not free. On the other hand, if you lived in the country you understood that, though the population was forced into this contract, it was accepted, not just because there was no other way, but because people liked certain aspects of the contract.<sup>51</sup>

Who, then, chose this contract and why? To understand Real Socialism, we need to explore the particular relationship between workers and the group we have been calling the planners.



## THE SOCIAL CONTRACT

Consider the course of our discussion of Real Socialism. We began with a "real fact," the real concrete. The omnipresence of the phenomenon of shortages was our point of departure, and we traced the apparent source of shortages to the relation of planners and enterprise managers. Further analysis, however, led to the conclusion that the inner connection that generated these phenomena was to be found in the relationship between planners and workers—a relationship crystallized in the simple concept of the social contract. With this concept, we can try to retrace our steps to develop an understanding of Real Socialism as a whole.

We should note immediately, though, two silences related to the concept of the social contract. One concerns the place of the enterprise managers. After all we have said about them in this chapter, where do they fit in this social contract?

The second silence concerns the key link between human development and practice. Where in this discussion of the social contract is there a focus upon the full development of human beings, a stress upon revolutionary practice, the emphasis upon the development of people through their activity in the sphere of production and in every aspect of their lives, the development of socialist human beings?

These silences are not accidental. In this concept of a social contract between planner and worker or, rather, between vanguard and worker, we can see the characteristics of the dominant relation of production in Real Socialism. This apparent social contract permits the reproduction of that relation, which we will call the *vanguard relation of production*.

