

Studies on the soft budget constraint syndrome, on innovation and great economic systems in honour of János Kornai's birthday*

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*Constraints and Driving Forces in Economic Systems:
Studies in Honour of János Kornai
Edited by: Balázs Hámori and Miklós Rosta Cambridge Scholars,
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János Kornai turned 85 on 21 January 2013. On the occasion of his birthday, the Corvinus University of Budapest – with the support of the Central-European University and the Magyar Nemzeti Bank, the central bank of the Republic of Hungary – organised a conference with a full house. The materials of the conference are available on János Kornai's personal website,¹ and not only daily papers, but scientific magazines also published reports on the conference (*Blahó 2013, Farkas 2013, Kerényi 2013, Rosta 2013, Tardos 2014b and Tóth 2013*). As editors,² Balázs Hámori and Miklós Rosta selected catch phrases that capture the essence of János Kornai's work³ – innovation, the soft budget constraint syndrome, paternalism, excessive centralisation – and thus were able to work with a tight logic in formulating the book which contains the studies of various authors representing various disciplines, such as anthropology, economics, political science and history.

The title is quite apt, as it is a fact that driving forces and constraints formulate economic systems by making each other both weaker and stronger at the same time. On behalf of the editors, Balázs Hámori introduces the book and the studies in the preface, at the end of which he makes a witty and respectful reference to the famous saying of Dostoevsky: "we all come out from Gogol's Overcoat". Balázs

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¹ <http://www.kornai-janos.hu/Kornai85.html>

² The merits of the editors are not diminished by the reference worthy of a footnote that a book of studies had been published before by a prestigious international publisher in honour of János Kornai's birthday (*Maskin-Simonovits 2000*).

³ János Kornai has been elected to the National Academy of Sciences (NAS) of the United States of America, he is the first Hungarian member of the Economics section, which includes 20 Nobel laureates of its 68 American and foreign members.

Hámori says that all the authors of the book come out from Kornai's Overcoat. The book ends with endorsements: the book is recommended to the readers by respected persons such as Eric Maskin, professor at Harvard and economic Nobel prize winner, Geoffrey M. Hodgson, chief editor of the Journal of Institutional Economics, and Chenggang Xu, professor at Hong Kong University.

The basic question of László Csaba's study entitled *Introduction: Constraints and Driving Forces in Economic Systems* can be summarised by asking what is the current importance of so-called *comparative economics*. The author thinks that since the work of Paul A. Samuelson, at the leading universities of the world and in the academic magazines, the neoclassic synthesis is the most determining, positivist, value-free and strongly technical mainstream paradigm, the research programme and method of which – in simplified terms – focuses on the question how the players of the economy should behave if they were rational. László Csaba describes this phenomenon – referring to Edward Lazear's term – *as economic imperialism*, and thinks that neoclassic quantitative fetishism uses very exact mathematical and microeconomic tools to explain the operation of each area of life, from marriage to discrimination. In the opinion of László Csaba, moderately rational individuals form a complex system, in which, based on incomplete information, decisions are often made in the spirit of peer pressure. In his work, the author refers to the fact that it is wrong to say that history is over, the era of endless happiness has come, it is worth looking at Russia to see that a very special form of capitalism has been realised there after the fall of socialism, and in a political and administrative sense, we cannot talk about democracy in Russia any longer.

The introductory study is followed by the first part of the book, entitled *Innovation as a driving force*. In Karen Eggleston's article entitled *Innovation, Shortage and the Economics of Health Care Systems*, the author points out that Kornai examined the great, breakthrough and revolutionary innovations of every-day life – almost one hundred cases – and came to the conclusion that revolutionary innovation might be the greatest strength of capitalism (*Kornai 2010*). Eggleston extends this meticulous method to health inventions: in this area, was it in the capitalist or socialist economies that the greatest innovations were made? The result cannot surprise the readers: In Eggleston's views, in socialism, the health sector was not characterised by innovation at all, and socialist economies were not any more advanced than capitalist economies. In addition to health innovations as a feature of capitalism, Eggleston refers to the fact that shortage phenomena that are the inherent features of socialism may emerge in capitalism as well, but as isolated islands only. One of these areas is the health service which keeps producing a deficit even today, and Eggleston has invested a lot of research work to understand this issue, jointly with Kornai (*Eggleston-Kornai 2001*). In this study, Eggleston expresses her view that health-economics is the only area in capitalist countries regarding

which it is still debated whether the state or the market could provide more efficient care.

Gérard Roland's study entitled *Individualist and Collectivist Culture and Their Economic Effects* gives a comparative overview on the economic effects of individualist and collectivist cultures. The author agrees with Kornai in the fact that innovation is the biggest strength of capitalism as opposed to the socialist economic system. Roland thinks that looking at it from psychological point of view, the driving force of innovation is found in cultural factors. The author finds that where innovating forces, inventions and innovation play a leading role, there are always individual initiatives in the background, and against this positive feature, in individualist cultures, group interests fade into the background, and individuals find it harder to identify themselves with group interest anyway. In collectivist cultures, society reacts much easier and faster for the sake of group-level issues, but this media suppresses individual initiatives and intensifies conformity.

The essay of Katalin Szabó and Balázs Hámori in the book of studies, titled *Reinventing innovation* presents the effects of the latest innovation trends on economic systems: they point out the so-called *crowdsourcing* – the outsourcing of the activity to a wider community – and the so-called *reverse innovation* – innovation of reversed direction. The authors find that the innovation methods bear the features of the social and economic systems that host them, and therefore it is not possible, or not worth skipping a comparison at the system level. In the summer of 2016, at an event organised for the 70th birthday of Balázs Hámori, Kornai drew the audience's attention to the fact that his work was greatly influenced by the joint studies of Katalin Szabó and Balázs Hámori (e.g. *Hámori-Szabó 2012*).

Péter Mihályi praises Kornai's importance in his study titled *Kornai's Anti-Equilibrium, a harbinger of evolutionary economics*. As to Kornai's book titled *Anti-equilibrium (Kornai 1971)*, he himself said in his memoirs that "it was not an item in my publication list. This was the most ambitious challenge in my research career" (*Kornai 2007*). In this work, Kornai did not create a new theory, but provided criticism, which was read by many people in the United Kingdom, the United States, France and Hungary (*Tardos 2014a*). At the time of writing the book, Kornai thought that the neoclassic way of thinking acted like a straight jacket, and it would require no less than a revolution to get out of that. A later leading economist of the International Monetary Fund (*Blanchard 1999*) said about this work of Kornai that the author had no reason to complain, as several of his scientific ideas (asymmetric information, game theory description of companies, the labour market bargain, the role of the government and the legal system, the non-complete contracts, the non-Walrasian state of the economy) became subjects of thorough research.

Mihályi strengthens this positive approach:⁴ he also thinks that the criticism of Anti-equilibrium has already been incorporated into the arguments of various schools that are against the general balance theory, and demand change in paradigm, but this adaptation process is made weaker by the fact that – in the opinion of Mihályi – the impact of Kornai can be detected in an indirect way only, in a number of cases. Anti-equilibrium has proved that the assumptions of the neoclassic school run against reality, and therefore the conclusions drawn from incorrect assumptions may not be correct, either.

When the Collegium Budapest⁵ operated, Kornai organised three large international teams to examine the economic, political and sociological problems of transition, they were as follows: From planned economy to market economy 1993/94; Relation of politics and economic policy in post-socialist countries 1997/98; Honour and trust in the light of post-socialist transition 2002/03. Gábor Klaniczay's very detailed study titled *A New Kind of Academic Institution: The Institute for Advanced Study. International and Hungarian Experiences* gives an insight into the operation mechanisms that characterise the so-called *Institute for Advanced Study* (IAS) institutions. IAS's in the world can be found from Princeton to Berlin, from Stanford to Uppsala, from Nantes to Bucharest, and, thanks to Klaniczay, we learn not only the difference between them and universities, research institutes and academies, but he describes why a real IAS institution, the Collegium Budapest was viable only for 19 years in Hungary. Kornai was involved in the organisation of that institution founded in 1992, right up until its termination. Klaniczay and Kornai considered the termination of the Collegium Budapest as their personal tragedies in 2011.

Klaniczay's article is followed by the second part of the study book, entitled *Soft Budget Constraint and Over-Centralization as Constraints*.⁶ The first article was written by Dóra Gyórfy,⁷ who was previously involved in the research activities of Collegium Budapest on a scholarship. Her article is titled: *Soft Budget Constraint and the Greek Tragedy*. Gyórfy explored the reasons behind the failures in the management of the Greek financial crisis by using the soft budget constraint syndrome created by Kornai. The author analyses the symptoms of the Greek crisis with scientific care, as well as the many intervention attempts following the outbreak of the crisis, and the soft budget constraint syndrome may be the best description for all that. Kornai first used this good description in 1976, in a series of lectures held in Stockholm, at that time only for the purpose of describing socialist companies, saying they operated irrationally, but in the past decades, this term has

⁴ This study was published earlier in Hungary in leading magazines in both Hungarian and English (*Mihályi 2013a and Mihályi 2013b*).

⁵ In the memoirs of Kornai, an independent chapter was dedicated to Collegium Budapest (*Kornai 2007*).

⁶ Detailed studies were published on the spread and the effects of centralisation and the soft budget constraint syndrome (*Kornai 2013 and Kornai 2014*).

⁷ This study was also published in Hungarian (*Gyórfy 2013*).

taken on a life of its own and has gone far. The most important common feature of the various forms of the soft budget constraint syndrome is that it influences the behaviour of an organisation if it knows that it will be saved in the case of a serious financial problem. By using the soft budget constraint syndrome, Gyórfy shows what was going on in the background of the motivations of the key players in the events, the institutions of the European Union, the international markets, the Greek State, tax-paying Greek companies and households, as they were sure that the institutions of the international market and the Troika would not let them go bankrupt. One of the conclusions the readers can draw from the study is that if the budget constraint had been harder, the Greek crisis management had not failed, and the extent of downturn was only increased by the fact – even with the best intentions – that the trouble was concealed because instead of constraints that are not popular on the short term, the Greek, European and American leaders wished to solve the crisis by providing additional funds, and the soft budget constraint conserved a bad economic structure. As opposed to this practice, the hardening of the soft budget constraint – not as a magical tool that cures everything – would have encouraged Greek structural reforms at the international level. Nowadays, many important economists think that this crisis management was incorrect, but an extreme hardening of the budget constraint may also not have been a solution to the Greek crisis.

In András Simonovits's study entitled *Paternalism in Pension Systems*, the features of the socially optimal paternalist transfer system are examined, and the author postulates that a pension is a compromise between autonomy and paternalism.⁸ Kornai rejects both individual and state paternalism, which reduces autonomy and once said the following about the theoretical background of this position: *"to me, autonomy itself has a very high value. Even if fifteen local governments out of one hundred make wrong decisions – at least all the one hundred did some thinking about it. They act in awareness of their responsibility, right there, on the site. There are the local administrative experts, there are the teachers, there are the parents themselves, the pupils"* (Friderikusz 2013). In the study, Simonovits presents some special transfer (tax and pension) models, in these models, individuals may optimise their position in various ways: they participate in a mandatory pension system, reduce their labour offer and hide some of their earning. The common frame is the static two-generation model, in which individuals work in the first phase of their adult lifecycle, and they are retired in the second phase. The government operates a linear transfer system that is well-balanced on the average, but has some upper limits. Individuals may optimise their position from various aspects: they may save up with tax benefits; without benefits, if they enjoy pension credit, or are faced with upper limits of contribution base; they may decide how much they will work and

⁸ This study was also published in Hungarian (Simonovits 2013)

how much salary they admit. Individuals are typically short-sighted, and therefore when they are on their own, they make decisions that are worse than the optimal. The author traces back pension paternalism to short-sightedness and the lack of competent market players, as short-sighted players are able to save up private funds, but not enough; on the other hand, the state is able to force them to make contributions, but this is not efficient enough.

In Miklós Rosta's study (*Janus-faced Public Administration Reform in Hungary*) the author points out that Kornai's contribution to social sciences is still up-to-date and valid, and Rosta thinks that the system paradigm as a scientific approach is one of the most suitable frameworks to allow us to evaluate current social processes. Kornai's ideas may be related to economics, but his works exceed the limits of this discipline, and had a stimulating impact on all areas of social sciences. In order to support his statement, Rosta starts from the terms of soft budget constraint and excessive centralisation and then describes how the public administration reforms of the government in power since 2010 in Hungary can be interpreted by using the terms of this framework. The author presents a number of examples in his study to illustrate excessive centralisation (e.g. the establishment of the Klebelsberg Institution Maintenance Centre, the KLIK), the operation of the mechanism with orders (e.g. manager staff number limit of 15 and 10 per cent in ministries and related agencies), and the survival of the soft budget constraint (e.g. final repayment). At the end of the study, relying on the results of the positive examination, normative statements are made about the new system.

There have been significant transformations and changes going on in the Hungarian higher education since 2010. At the time of writing the article entitled *Dancing in a Sack – How did the transformation of the governance of higher education affect the performance incentives of educational stakeholders?*, Eszter Rékasi was still a university student and she tries to describe these changes. The author refers to statistics which show that the ratio of expenses allocated to higher education within the central budget has dropped dramatically. In her analysis, the author refers to Kornai's results published on coordination mechanisms and projects the expected impacts of the measures on the basis of these analogies. Indeed, professional discussions and civil demonstrations cool and heat this issue which is very important for all of us, as the institutions of Hungarian higher education significantly determine the education level of the workforce, the development of research performance and social mobility, thus the limits of the economic capacity of the country.

Rékasi's article is followed by the short introduction of the authors of the book. For professional researchers and experts interested in economics, comparative economics, political science, history, comparative system theory, the opposing pair of capitalism-socialism, and for university students attending social science classes, the studies in the book may be exciting and enriching reading.

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