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**János Kornai: From Socialism to Capitalism. Budapest: Central European University Press, 2008.**

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Kornai's latest volume contains 7 papers written over the past 20 years. The earliest one was a lecture originally presented in March 1989 in Moscow (Chapter 2), the latest ones were written or published in 2005, one of them (Chapter 6) appears in English for the first time in this volume. The book begins with papers summarizing Kornai's work on the political economy of state socialism the rest belongs to the subfield known as "transitology" in social sciences.

With Oscar Lange Kornai ranks as the most distinguished and influential political economist of state socialism (or whatever name you want to use for the socio-economic systems, which existed after 1917 across the globe from Russia to China and which still struggle for survival in two countries of the world: North Korea and Cuba).

The most admirable feature of Kornai's work on socialism and post-communism is his consistence. From his wonderful book on "Overcentralization" (which was his Ph.D. dissertation and appeared in English already in 1959), through his "Rush versus Harmonious Growth" (1972), "Economics of Shortage" (1980 – the work what I still regards as his most important contribution to institutionalist economics and for which he was nominated repeatedly for the Nobel Prize, a recognition he would have well deserved) to the "Socialist System" (1992) he built the most comprehensive and convincing analysis of the socialist economic system. The oeuvre is astonishingly coherent. The most remarkable aspect of Kornai's work is not so much that he knew it all along, but rather his ongoing and uncompromising struggle to understand the nature of socialism. He was always ready to learn and readjust his explanations as the world of communism changed. Kornai is one of those rare social scientists, who do not pretend he was always right, but all his life he made a strenuous effort to find the theory which offers the best fit to the rapidly changing world around him even if it meant to re-think, if necessary to change his earlier views.

Kornai started his career as a journalist with virtually no training in economics writing on economic matters during the worst Stalinist time for the central daily newspaper of the Hungarian Communist Party, Szabad Nép. As he gradually understood the inefficiencies of what he calls in Chapter 1 of the present volume of the "classical system," he became one of the leaders of journalists expressing their dissent against Stalinism. Kornai abandoned journalism, taught himself economics (even some econometrics) and moved on to develop his formidable, ever deepening critic of socialism. From a devoted communist he became eventually a forceful

(though always sober, never dogmatic) advocate of free market economy and pluralist democracy.

His point of departure was the recognition that the classical system is unworkable since it is over-centralized. Publishing a book along those lines in 1957 was a courageous act. Though Kornai's primary aim in his first book and in most of the following ones was primarily *not* to offer recommendations for reforms, but to explain the reasons for the malfunctioning of the socialist economy, the book at least in Hungary (but arguably indirectly in some other socialist countries, like Yugoslavia, pre-1968 Czechoslovakia and Poland) affected economic policies and serious attempts were made to create a more decentralized forms of management.

Kornai soon learned that even radical decentralization will not be sufficient to correct the inherent problems of communist economies. Since these systems were implemented in economically backward countries, socialism became a strategy of accelerated, or "rush" growth, especially what was known in Marxist political economy accelerated development of Department I. Well, harmonious growth, a shift from obsession of development of heavy industry and mining to production of consumer good, infrastructure, to the tertiary sector is what may be needed. It was the year of the publication of "Rush versus Harmonious Growth" that Kornai invited me and my friend and co-author, George Konrád to visit him. We had just published in 1971 an article, "Social conflict of under-urbanization," which created a major scandal in Hungary, though I still regard this as one of the better pieces I ever wrote. Similarly to Kornai's book we argued that the single most important characteristic of socialism is overinvestment in the productive sector and neglect of consumption, especially infrastructure. This was the first time we met in person: he was kind and generous, but already in nearly 1972 he was highly critical of our attempt in this paper to cast our analysis as a problem of social conflict, in fact as a problem of class conflict and exploitation. This paper was my first flirt with Marxism and already in 1972 Kornai was well beyond Marxims and strongly disapproved it.

In 1972 with Konrád we just began our work to identify socialism as a "redistributive economy" and within a year or two our neo-Polanyian theory was completed. Kornai did not like our term "redistributive economy", as it reminded him too much of welfare redistribution of the social democratic welfare state. So he proposed the idea of bureaucratic coordination. Chapter 1 of the current volume summarized his major new arguments, In his view there are two fundamental forms of economic coordination: market and bureaucracy. But it would be wrong to merely see bureaucratic coordination as "central planning" or "command economy", it is rather a system in which central authorities are linked to enterprise management by paternalistic ties (and management similarly adopts a paternalistic attitude towards workers). Under these circumstances the central authority is unable to issue mandatory commends, rather it engages plan-bargain with management, which creates soft budget constraints for firms. In market economies firms have hard budget constraints: if they do not produce profit they go under. In socialist systems budget constraints are soft: inefficient firms are bailed out by governments. Since firms can always anticipate bail-outs they will present constantly excessive demands,

which inevitably leads to chronic shortages. Bureaucratically coordinated economies are economies of shortages. Bingo! That was it: Kornai just produced the most powerful description of the way socialist economy worked and he accomplished this in a value neutral manner, this book is a match with the best of institutionalist economics, a book indeed worth the Nobel Prize.

Kornai in Chapter 2 of this volume is a courageous lecture given at a conference in Moscow in March 1989 well before the USSR and its Communist Party (and the KGB) crumbled. It makes one important step further: if one opts for markets eventually one will have to accept the domination of private ownership. Already in his path-breaking 1984 article on “Bureaucratic and market coordination” Kornai established that there is an “elective affinity” between bureaucratic coordination and public ownership, and market coordination and private ownership, but he did not get as far as to suggest that consequently carried it market reforms will lead to capitalism. Now Chapter 2 foreshadows what is to come in *The Socialist System*. He is still careful though, Figure 2.1 is still about elective affinity and does not exclude the possibility of mixed economies. But he is more forceful in Chapter 3, first published in 2008, where he not only calls market socialism an illusion but arrived at the conclusion that China and Vietnam, given their radical market reforms, are capitalist economies for all practical purposes. No more nonsense about “third ways” or mixed economies, combinations of socialism and capitalism, markets with public ownership or control, or public ownership with, market integration with state redistribution or a mix of those arrangements.

This leads him to argue in Chapter 7 (as far as I can tell he developed this idea already in 1992) that socialism created a “prematurely born welfare state”, which is to be reformed by allowing “individual freedom of choice” (p. 176) and leaving it to a “sense of solidarity with those in a disadvantageous positions and not capable of paying out of their pocket the costs they will incur if they are in trouble”. I can hardly read this as something other than a UK-US style means-tested temporary “poor relief” while people are in trouble and otherwise market arranged insurance schemes (Esping-Andersen 1990) and at the same time cutbacks on the excessive expenditures of the “prematurely born welfare state”.

This is an admirably consistent argument and I am the last one who would or can blame Kornai for readjusting his analysis to the changing realities of the world. I like his lack of orthodoxy, his soberness, his realism. With all due respect to his splendid scholarship and acute sense of political realism I do have to express my disagreement though with some of his analysis, especially with some of his conclusion he arrived at in *The Socialist System* and many of the chapters of his current volume.

First of all, I did and still do have my debate with Kornai about the accuracy of “bureaucratic coordination”. This is far from just a terminological controversy. I believe Kornai does not quite appreciate the Polanyian meaning of redistribution and like earlier critics of my work he did not see the fundamental difference between a redistributively integrated economy (where the “surplus” – the resources which can be used for investments or turned into profit - is

concentrated in a central hand before being redistributed) and the welfare redistribution of capitalist states, which redistributes incomes earned in and determined by markets in the name of social justice and/or solidarity. Bureaucratic coordination does not really capture what the socialist state does, it describe *how* they do it (though doing coordination bureaucratically is hardly a characteristic of capitalist states). If we can believe Weber, bureaucracy is the purest form of “legal-rational domination.” It is present not only in the capitalist state apparatus but also in the large privately owned corporation Oliver Williamson called it “hierarchy” - but it tells us little about *what* states do. So the crucial question is whether incomes of firms or individuals are determined on price regulating markets, and whether those firms and individuals can dispose with such income (profits), with some limitations imposed on them by usually impersonally defined and universally applied taxes.

If we understand socialism in this sense as a redistributive economy we can see with clarity that socialism *was not only a prematurely born welfare state. In fact, it had no welfare state at all.* In the East European parlance economists and politicians quite rightly write about the “great distributive systems”, rather than “welfare systems”.

It is indeed a common misunderstanding to see the socialist great distributive systems (pensions, healthcare, funding of education) as identical with what used to be the Scandinavian social democratic universal welfare insurance system (Esping-Andersen 1990). That system provided as citizenship right free universally high quality services. So middle or even higher incomes did not see a need to seek market based provisions (which otherwise were available to them) and were willing to pay high taxes to receive publicly provided healthcare, pensions and education (even tertiary education). I am not arguing here that this was a perfect system, but it had precious little to do how the “great distributive systems” worked under state socialism, especially what Kornai called under the “classical system”.

There are three great mythologies about the great distributive systems under socialism, namely that they (a) were universal, (b) offered equal services and (c) were free. These are characteristics of social democratic universal welfare insurance schemes as described by Esping-Andersen (1990). The socialist great distributive systems were hardly universal. They typically were only available to those in state employment. Even those in the cooperative, or kolkhoz sector hardly had any access, not speaking of the “criminal”, “hooligan” elements either incapable or unwilling to be gainfully employed. So access to the great distributive systems was a reward for work, not a right earned by citizenship. The services were hardly egalitarian. Higher cadres lived in better housing. They had access to better medical services, shopped in special shops for scarce goods with even more subsidized prices, their children had higher chances to get into institutions of tertiary education, and even higher quality primary or secondary schools etc. And of course all those services were free only for the higher ups. Poor people could not get public housing, had to build for themselves on the market (Szelenyi, 1983), ordinary people had to “tip” doctors to get a bed in a hospital or have an operation in a timely manner, though cadres went to special clinics and hospitals where tipping was illegal, where the

best qualified doctors worked and where patients had their private rooms. So the services were free for those who could have afforded to pay for them but were quite expensive for those in the lower income brackets. It is also true that income inequalities were low and the great distributive system in a way “corrected” for artificially low income inequalities. The great distributive systems operated as fringe benefits, which benefited those whose contribution to society were appreciated more by the authorities who set wages and determined access to services provided by the great distributive systems. This was *not* a welfare system as we normally understand it. It was a workfare system, a system of fringe benefits. To put it very simply: while in capitalist welfare systems income inequalities are higher before redistribution and somewhat lower after redistribution, in socialist redistributive systems income inequality appears to be low, but actual social inequalities are higher if we take into account what people receive from the great distributive system. As I put it in my 1978 article: while in market economies market creates inequalities and redistribution moderates those inequalities in redistributive economies redistribution creates inequalities and markets moderate them.

Kornai’s theory of “prematurely born welfare state” had negative policy implications. From the theory it follows one should cut back the overgrown welfare state -- and that is what post-communist societies did, which resulted a deepening of split between the poor and the rich. Yet the task, following my theory, should have been to *create* a capitalist welfare state from the socialist workfare state. It is not simply true that the former socialist societies spend too much on welfare. Both the Czech Republic and Hungary spend for instance less per capita than Spain or Greece. What is true that they do not spend it wisely, since the logic of socialist workfare state still survived: even those who could afford to purchase such services on the market or private insurances are funded from taxpayers money. Reform of the great distributive system is indeed needed, but the main aim is not to cut back expenditures on health care and education, but to redistribute it from the rich to the poor, rather than the other way around.

Let me make a final point about mixed economies and the elective affinity between forms of economic integration and property rights. It is far from obvious that the purer the economic systems are, the better they work. It is far from obvious that clearly defined private property rights work best with unregulated free markets. The capitalist world economy experienced its fastest growth with the lowest income inequalities when at least in continental Europe substantial sectors of the economy (even some sectors of the industry) were publicly owned and managed and when government implemented quite extensive interventions into the workings of capital markets. The performance of core capitalist economies after substantial privatization and deregulation of markets was underwhelming and nowhere near the growth rates of the 1950s and 1960s while the incomes (and wealth) of the top deciles exploded in comparison with the incomes at the bottom of the society. As I am writing this review, March 2009, governments around the world had already spent \$11 trillion from taxpayers money (about \$1,500 for every individual on this globe, including those living in poor African or Asian countries) to bail out the private sector. It looks like private firms in the absence of strict government regulations can

have also “soft budget” constraints. It is not inconceivable that a large proportion of the banking sector has to be nationalized to rescue the world from a crisis which can be worse without massive state intervention than the 1929-33 Great Depression was. At least at the moment when I am writing this review it looks like mixes of public and private ownership, planning and markets are not only possible, but may be necessary for the survival of capitalism. Capitalism and free markets have to be defended by smart states from capitalism, from laissez faire. This reads like some sort of “third way” to me.

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