

BOOK REVIEW:

"BY FORCE OF THOUGHT: IRREGULAR MEMOIRS OF AN
INTELLECTUAL JOURNEY" by JÁNOS KORNAI

GUR OFER

Many economists in the former communist bloc countries and other countries as well will certainly recognize at least some of the following terms: overcentralization, two-level planning, anti-equilibrium, economics of shortage, soft budget constraint and immature welfare state. Most of them are titles of books written by Kornai and the rest are terms he coined. All of them have become familiar to economists and others. The order in which they appear here encapsulates the development of Kornai's thought (and to a large extent the field as a whole) and the characterization of the communist economic system: its problems, the reasons for its collapse, the tradition it has left behind and the "transitions" it has undergone.

János Kornai is a Hungarian economist who in his youth was a devoted communist and Marxist. He taught himself Western economics, primarily from textbooks. In the early 1950s, he tried to suggest modifications to the system of central planning but a number of years later—and well before it became fashionable—he abandoned his communist beliefs and later his support for Marxist economic theory. He was to become a leading economist in the analysis of the "socialist" economic system in what was known as the Eastern bloc. Kornai is without a doubt one of the leading experts world wide on the communist system. All his major works have been translated into English (and later into other languages) and were published in the West shortly following the Hungarian version. Kornai chose to live in Hungary, and even when he became a full professor at Harvard in 1985, he shared his time between Cambridge and the Institute of Economics of the Hungarian Academy of Sciences and then the Collegium Budapest, an institute of advanced studies that he helped to establish. Following his retirement from Harvard in 2002, he returned to Budapest and to the Collegium Budapest.

In early 2008, Kornai celebrated his 80th birthday. A simple calculation reveals that, in addition to a long academic and research career, Kornai has personally experienced the horrors of the Second World War and the Holocaust, the creation of a communist regime in Hungary (and its many transformations) and finally the "transition" to a market economy and democratic regime. These life experiences go far beyond just academic economic research, and indeed his autobiography describes events and confrontations of much greater significance and an ongoing decision-making process whose results could have had dire consequences. Thus, although most of his autobiography that is discussed here deals with the development of Kornai's economic work, he describes a life that includes much more than that, and which to a large extent involved difficult ethical decisions and dilemmas.

I will return to this later on. To begin, I will survey Kornai's economic work, as is appropriate for a journal such as the *Israel Economic Review*.

The first of two early and important economic works by Kornai (published in 1957) dealt with *Overcentralization* and was based on his doctoral thesis on the failures of the central planning system in Hungary (and elsewhere). The second, published in 1965, concerned *Two-level planning* and suggested a way to correct some of these and other failures. The book on *Overcentralization* was based on knowledge and experience that Kornai had accumulated as a journalist reporting on agriculture and light industry. These failures were the result of shortages of information and distortions in its flow from the field as it climbed up the bureaucratic hierarchy, the lack of control and oversight, and the inefficient use of incentives by distant central planners who were out of touch with factory managers in the field. The resulting failures include the focus on one main criterion for measuring efficiency and success and for awarding material incentives, i.e., the fulfilling of production quotas, and the neglect of other important criteria, such as profitability. The "sanctification" of meeting 100 percent of the production quota led to distortions in the production process. These include: the accelerated activities towards the end of the year; the misallocation of production to seemingly "profitable" goods; the failure to identify potential for increasing production and efficiency in order to avoid determination of higher production quotas by the planners; the focus on short-term results at the expense of efficiency and technological innovations in the longer run; misallocation of production to the "second economy"; and many other activities characterized as moral hazard.

This work, published in the West in 1959, was along similar lines to those of Western researchers on central planning in the USSR published during the same period. Some of the latter were based on interviews with factory managers and others who had defected to the West towards the end of the Second World War.¹ Kornai's contribution was particularly important since it added a professional testimony from the other side of the Iron Curtain.

An attempted partial solution to the problems mentioned above appeared in Kornai and Liptak (1965). It involved two-level planning in which the central planners decide on production quotas for sectors as a whole and then the individual sectors prepare production plans consistent with those quotas. The result is the streamlining of the flow of information and incentives that are more consistent with the planner's goals. Two-level planning was also proposed by Oscar Lange in his classic work on socialist economics, which was later developed into a formal model by Malinvaud (1967). The difference is that in Kornai's work, the signal from the central planners to the various sectors consists of required quantities rather than prices, as in the other models of "market socialism." The two-level planning models were the first to discuss the idea of "market socialism" which took center stage in the discussions of reforms of the central planning model for many years to follow. There was somewhat less interest in the Kornai-Liptak model, although in principal it was more consistent with the actual practice of central planning.

Although Kornai had abandoned Marxism already in the early 1950s, this last work and other works on two-level planning represented an effort to achieve a more efficient system

¹ See among others Berliner (1957), Granick (1954, 1960) and Nove (1958).

of planning. Such efforts did not stop the authorities from viewing these papers as heresy ("revisionist") and as justification for repeated and drawn-out police investigations.

Kornai's work on an alternative planning model led him also in a different direction, to question the theory of general equilibrium and the principles of neo-classical economics in general. In his book *Anti-Equilibrium*, which was published in 1971, Kornai claimed that the model of general equilibrium as developed by Walras, Arrow and Debreu, and others is not general enough and describes only part of actual economic activity. The extensions that Kornai proposed had two main components: The first is a long list of market failures, information failures and transaction costs and signals, which replace prices and constitute a bridge between the abstract model of equilibrium and reality (in both the capitalist market system and the socialist system). The second is that the neo-classical model of equilibrium is a static one and therefore lacks the dynamic elements that lead to economic growth, the lifeblood of capitalist economics. This component is to a large extent dealt with separately from the model of equilibrium as part of the theory of technological innovation and economic growth. The interpretation given here to Kornai's arguments on market failures and on growth is universally accepted and is discussed at length in Western economic literature. As a result of the manner in which Kornai chose to attack the theory of equilibrium—as a general error in the approach of economics—and also due to his use of a different economic language, the work was not widely accepted, although specific components of it were. In his autobiography, Kornai confirms that "One problem is the style or "genre" in which it is written." (p. 193); and since the book did not correctly evaluate the role of the neo-classical model of equilibrium, "It is regrettable that *Anti-equilibrium* did not appreciate that valuable role sufficiently" (p. 185).

Both Kornai's books on *Overcentralization* and on *Anti-equilibrium* criticized the communist system's strategy of "rush growth" and of unbalanced growth, i.e., the overemphasis on investment and heavy industry at the expense of consumption. In his opinion, these two phenomena lead to inefficiency and a waste of resources. A formal presentation of these claims appeared in his book *Rush versus Harmonic Growth* published in 1972. These ideas were also in line with those of Western "Sovietologists" who were emphasizing more or less the same points during that period.²

Kornai, more than anyone else, is associated with the dual concepts that characterize the economics of central planning: the *economics of shortage*, caused by, among others, a *soft budget constraint (SBC)*. The *SBC* was developed in 1979³ and *The Economics of Shortage* was published in 1980. The former described shortages in centrally planned systems as a general and chronic condition and discussed its results at length: inefficiency in production, a sellers' market, lack of competition, slowed technological progress, lower consumer utility as a result of long lines, the purchase of non-optimal substitutes to the desired goods and many other well-known features. However, Kornai's initial explanation of the phenomenon did not involve deficient planning, prices that were intentionally set too low or evil intentions on the part of planners, but rather that it was the direct result and essence of

² Grossman (1962) and Berliner (1966).

³ The first article by Kornai on the *SBC* was rejected by the *AER* and was eventually published in *Kyklos* in 1986.

the central planning system. Therefore, all that the various reforms could perhaps accomplish is to somewhat ameliorate the phenomenon. The main explanation for the shortage feature is the *SBC*, which encourages enterprises to increase their demand for investment, workers and other inputs and which allows unprofitable enterprises to continue operating.

In his work on the *SBC*, Kornai primarily emphasizes its effect on the expansion of demand and the resulting shortage. The main motivation for the *SBC* is the paternalistic approach of the government to the fate of the enterprises and their workers. The government cannot tolerate the closure of an enterprise it created, the firing of workers or the loss of production capacity for important goods. Only at a later stage did Kornai attribute to the *SBC* the effects of "moral hazard" and its negative effect on incentives and therefore on efficiency, innovation and growth. In time, these effects of the *SBC* became part and parcel of economic theory in general and contract theory in particular, and relevant in the context of socialist systems as well as bureaucratic structures under any economic regime and even market systems. Kornai took part with others in further work on the *SBC*.⁴

Only in 1992, already following the collapse of the communist regimes in the Soviet bloc was Kornai's work *The Socialist System* published. The book is a comprehensive summary of Kornai's research and views on the socialist system and is without a doubt one of the most important books on the former socialist system. It is somewhat ironic that Kornai, who began working on the book several years previously, delayed publishing it so that he could devote himself to what he viewed as more urgent work on the "transition" from socialism to a market economy. Thus, his book became a kind of eulogy for the socialist system and its epitaph.

With the fall of the communist regime in Hungary during 1989, Kornai shifted the focus of his work, like many other economists of his kind, to the discussion of ways to make the transition from a socialist economy to a market economy. His book *The Road to a Free Economy*, published in English in 1990 (and previously in Hungarian), has been translated into many languages and became a focus of the discussion of optimal methods of transition. It constitutes a bible for some and a target of criticism for others. In general, Kornai supported the gradual approach to "transition," primarily with respect to the pace of development of the private sector and the privatization of state-owned enterprises. He opposed programs of rapid privatization and the distribution of shares in government corporations to the public. A process of gradual change should in the end lead to a capitalist market economy (pp. 350–2) based on private ownership. Kornai, who was among the vociferous opponents of the partial reforms implemented in Hungary from 1968 onward and which were based on state ownership of most enterprises, strongly rejected proposals known as the "Third Way" which were advocated by many in Hungary and elsewhere. These proposals involved a middle way between socialism and capitalism, based on "joint" ownership in various forms between individuals and the State.

In regard to the requirement for macroeconomic stability, however, Kornai favored rapid change. This involved cuts in government expenditures, including on social services

⁴ See Kornai, Maskin and Roland (2003), and Roland (2003) for recent literature surveys on further work on the *SBC* by Kornai and other economists.

and welfare. In this connection Kornai coined the term "immature welfare state," inherited (the welfare state) from the old regime. It was characterized by overgenerous pensions, health benefits and other social welfare services to which the new democratic (and populist) parliaments added further; at a time when the State's revenues were low and declining and its ability to tax limited. The immature welfare states found it difficult to achieve a balanced budget and to contain inflation. Here Kornai supported a limited reduction in social services and the transfer of some of them (such as parts of the health system) to the private and third, NGO sectors; and again, he became a target of criticism at home. Only after Hungary had experienced several years of stagnation and even a decline in production Kornai agreed to support a "half-turn," another term he coined, according to which macroeconomic restraint would be somewhat loosened, though with maximum caution, in order to free public resources for increasing investment (though not consumption) and growth.

In contrast to the period under the old regime, Kornai was now deeply involved in economic debates and in efforts to influence government policy, however still only as a professional economist and researcher. He had no direct involvement in politics and did not join any political party or movement.

It is beyond the scope of this article to discuss the many other aspects of the book (which is 461 pages long in large format) and other issues (in economics or otherwise) and perhaps more than anything else the rare opportunity to view the introspective process of a scientist. The rest of the review will be devoted to two important aspects of the book: Kornai as a devoted communist and later as a "heretic," and his relations with the regime until its collapse, and Kornai as a Jew.

Kornai as a communist and a "heretic": As a young man, Kornai was a devoted communist and Marxist and was deeply convinced of his beliefs, both emotionally and intellectually. This is according to his own account, which appears many times in the book.⁵ During most of his years as a communist, Kornai worked as a journalist (from 1947-55) at a newspaper Szabad Nep ("Free People") the main paper of the Communist Party. He was fired, along with many others, as part of the struggle between supporters of Imre Nagy, who in 1953 (following Stalin's death) tried to introduce a more moderate regime, and the more conservative branch of the Party which finally won the upper hand in 1955.⁶ The process of rejecting the regime and later Marxism began for Kornai from a moral jumping-off point. In his journalistic work, Kornai was often required to write untruths and at some point in early 1954, he began to avoid and even to refuse to do so. Even more significant, in the summer of 1954 Kornai met a friend who had been imprisoned for several years on political charges. His friend's account of torture, the pressure to admit lies and the distortion of justice led to an awakening in Kornai, even though he had been aware of similar arrests and trials and had known about the torture for several years. Kornai stresses this point in order to avoid the appearance of "did not know and did not see." His deep convictions regarding

⁵ When he first requested a visa to the US and declared that he was a member of the Communist Party, he refused to accept the suggestion of the immigration official to state that he had been pressured into joining.

⁶ Imre Nagy led the Hungarian government at the time of the revolt in 1956. He was ousted and imprisoned by the Soviet Army following its invasion and was executed in 1958.

communist ideology and his blind support for the regime led him to believe that the (false) charges were true, as were the verdicts, and that the means being used were necessary. He had also mourned the death of Stalin in the spring of 1953. By his account, the conversation with his friend opened his eyes. Nonetheless, and again by his own account, his path to "heresy" was a long one. What happened in the late summer of 1954 was that "My earlier view of the world was shaken when the *ethical* foundations collapsed. ... I could not accept without reexamination the intellectual structure resting on those unacceptable, baseless ethical foundations." (p. 61). But later on: "I am not saying the multiplicity of ideas then in my head disintegrated all of a sudden... That took a good while. But from that day on question marks replaced the exclamation marks... in the teaching of the Communist Party which I had accepted unquestioningly up until then." (ibid.).

His candor is amazing and very human, though it makes one think....

Kornai was fired from the newspaper in 1955 and from the Institute of Economics of the Hungarian Academy of Sciences in 1958 after the "confession" that he had delivered at a staff meeting was judged not to be authentic (as he had intended it to be) and after refusing to join the Communist Party, this time against the background of his support, and that of many of his friends, for the 1956 revolt. During this period, he abandoned Marxism completely, cut off all ties with the regime and with politics and started to train himself as a "Western" economist. However, he also decided not to act against the regime and not to join various initiatives in that direction. This included not to publish without authorization and to whatever extent possible not to violate the law. As mentioned, Kornai decided not to leave Hungary even though he had the opportunity of doing so following the events of 1956. These decisions gave him a reasonable chance of survival under the circumstances, though no better than that. During this period, particularly up until 1959, Hungary had an oppressive communist regime with numerous politically motivated investigations and trials.

Kornai, who was known as an opponent of the regime, was subject to a number of investigations during which he was demanded to provide information on acquaintances and others, some of whom were also under investigations. He was in constant danger of arrest and being tried. Kornai adopted a middle-of-the-road approach in this context as well. He would cooperate with the investigation but: "I was ready to say what I assumed the interrogator already knew. I was ready to divulge facts that I assumed would do no harm to those in custody." (p.117). Such a policy is easy to adopt but it is difficult to follow without crossing boundaries during an investigation. And indeed Kornai has guilt feelings about instances in which he confirmed information that, although already known to the investigators, had some impact on the fate of his friends.

An examination of documents that were made public after the change in regime revealed to Kornai that at least one personal friend and colleague of him had provided "incriminating" information on him and on others some of whom were free and others in prison at the time, information which went beyond the rule mentioned above. Many cases such as these were reported after the fall of communism and the opening of the archives of the secret services.⁷ This revelation further deepened the crisis Kornai was going through at the time of writing.

⁷ On being informed by friends, see pp 78, 113-122, and 163-176.

The decision not to publish articles illegally without the permission of the authorities had far-reaching consequences for a researcher who is interested in spreading his work. The fact that permission must be obtained from the authorities severely restricted what one could write, especially when such work involves criticism of the regime. Kornai took on himself what he called "self-censorship," which involved not writing material that would likely be rejected. Furthermore, Kornai also decided against the common technique of the time of writing "between the lines," which involves interspersing hints of what one really means without making an explicit statement. In addition, he decided against writing half-truths. The most notorious case is Kornai's decision not to write the last chapter in his book *Economics of Shortage*, which was meant to connect the underlying economic explanations of shortage to the character of the political regime (pp. 242-44, 253-55 and 261-62). This is an example, therefore, of the painful compromise he had decided to make in order to survive while continuing to work and publish.⁸ And who are we to judge?

Kornai did in fact deviate from his rule not to break the law by sending English translations of his important works to be published in the West. Almost all of them were accepted right away by prestigious publishers and by leading scientific journals (see list of publications) and his major works were translated into many other languages as well. Kornai was following the precedent of brave soldier Schweik who also decided not to ask permission when he knew it would not be granted (p. 139).

Kornai's approach in all these areas involved open dissent towards the regime and of no cooperation of any sort, but at the same time did not involve defiance or illegal activity. This pragmatic approach is perhaps not the most heroic but is nonetheless highly heroic ("...until you've walked a mile in his shoes"). Kornai himself is hesitant to claim that this was the best path to be taken. But we should not judge. Kornai is painting a picture with many hues of grey and of ethical dilemmas, which are nothing like the black-and-white contrasts that appear in some descriptions of similar experiences. And this is another expression of his understated heroism.

Kornai as a Jew: Kornai was born in Budapest to an assimilated Jewish family. His father was an attorney who primarily represented German firms that did business in Hungary and saw himself as a member of the German and Hungarian cultures. The anti-Jewish race laws instituted in the late 1930s and during the war by the Hungarian government emphasized the family's Jewishness and hurt its livelihood. Following the occupation by Germany in 1944, the concentration and dispatch of Jews to labor camps and concentration and death camps began. Kornai's father refused to hide and was sent to Auschwitz where he was murdered. The rest of the family used various methods (hiding, forged documents and flight) to survive until the arrival of the Soviet army. Kornai explains his adoption of communism first of all as a reaction to the rescue of the remaining Jews and also the fact that communism, as he saw it, rejected anti-Semitism in theory and, in his opinion, in practice as well. Only later did Kornai learn about the principles of communism and Marxism and began to identify with them intellectually as well.

Despite all this, up until the fall of the communist regime in 1989, Kornai did not attribute any importance to his being a Jew. He changed his father's family name from

⁸ Kornai was careful not to attribute other weaknesses in this work to "self-censorship."

Kornhouser to Kornai with the conscious objective of integrating within the general society. He totally rejected widespread claims that Jews held different views from the rest of the population and was especially indignant at claims that Jews had a greater tendency to support communism. ("Although Marx was a Jew, Engels, Lenin and Stalin were not." p. 25). The rise of open anti-Semitism after the fall of the communist regime, among people as well as among various political groups and parties, forced Kornai to react. He responded by emphasizing his Jewish identity in public (pp. 386-387). Is this a somewhat naïve approach to anti-Semitism? Kornai visited Israel and included a picture of the visit in the collection of photos that appear in the book.

Kornai chose a particular sub-title for his book: *Irregular Memoirs of an Intellectual Journey*. Indeed, they are quite irregular, but they reveal so much of the human experience and the emotional and intellectual turmoil during a period that was difficult, complex and problematic from so many points of view.

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