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## Wirtschaft

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Ungarns "Second Economy"

Bureaucratic  
and Market Coordination

RGW-Gipfel

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Wirtschaft, die Privat- und Allgemeininteressen in Form eines ständig erneuerten gesellschaftlichen Konsensus in Einklang brächte, ohne eine grundlegende Demokratisierung der politischen Machtstrukturen nicht möglich ist. Unter den gegebenen Umständen kompensiert die „zweite“ Wirtschaft lediglich partiell die immensen Unzulänglichkeiten des Staatssektors und führt sie zu einem Ausmaß der Privatisierung des gesellschaftlichen Lebens, von dem VAJDA zufolge „der klassische Liberalismus nur zu träumen wagte.“<sup>51</sup>

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<sup>51</sup> M. VAJDA, a. a. O., S. 61.



János Kornai

## Bureaucratic and Market Coordination<sup>1</sup>

### *Abstract*

The author distinguished four mechanisms of coordination conceived as the regulation of any kind of transformation and transaction process. They are the bureaucratic, the market, the ethical and the aggressive coordination.

Relying on the analysis of a few characteristic indicators the author reaches the conclusion that in Hungary (in spite of the general stand against bureaucracy) the scope of bureaucratic regulation is at best stagnating, but rather increasing. There are four cases of the tenacity of bureaucracy: 1. Bureaucracy is inclined to complement the general regulations with ever more concrete and detailed rules. 2. While bureaucracy is pushed back in some area, the point of emphasis of its activity shifts frequently to other areas. 3. If there is a shortage, and insofar as the market coordination does not fulfil its task, namely the adjustment of supply and demand to each other, then bureaucratic coordination becomes unavoidable. 4. Those having power in the bureaucratic system and those enjoying the advantages of the system fight for keeping their positions.

The author challenges the view that in the Hungarian society and economy both the market and the bureaucratic coordination should be pushed into the background and the role of ethical coordination increased.

The author takes an unambiguous stand for expanding the scope of market coordination. (And with this he urges the development of the Hungarian system of control towards more indirect, "more market" directions.) But, because of externalities, transaction costs and problems related to a just distribution of income and to monopolies, he holds that the survival of bureaucratic regulation is inescapable in some areas, of course, in a much smaller scope than is the case today.

### *Zusammenfassung*

Der Autor unterscheidet 4 Koordinationsmechanismen für die Regulierung jeglicher Art von Transformations- und Transaktionsprozessen: bürokratische, Markt-, ethische und aggressive Koordination.

Aufgrund der Analyse einiger weniger charakteristischer Indikatoren wird festgestellt, daß in Ungarn (trotz allgemeiner Abneigung gegenüber der Bürokratie) das Ausmaß bürokratischer Regulierungen im besten Falle stagniert, wenn nicht sogar zunimmt. Hierfür gibt es 4 Gründe: 1. Die Bürokratie ist geneigt, allgemeine Regelungen durch immer mehr konkrete und detaillierte Erlasse zu ergänzen. 2. Wenn die B. an einer Stelle zurückgedrängt wird, verlegt sie ihre Aktivitäten häufig auf andere Bereiche. 3. Wenn Knappheiten existieren und die Marktkräfte den Ausgleich von Angebot und Nachfrage nicht zustandebringen, dann wird bürokratische Koordination unvermeidlich. 4. Diejenigen, die im bürokratischen System die Macht innehaben und ihre Vorteile daraus ziehen, kämpfen um den Erhalt ihrer Position.

Der Autor vertritt die Ansicht, daß in der ungarischen Gesellschaft und Wirtschaft Markt- und bürokratische Koordination zugunsten der ethischen Normen zurückgedrängt werden sollten. Er plädiert jedoch zugleich eindeutig für die Verstärkung der Marktkoordination, d. h. Steuerung mittels indirekter Instrumente. Allerdings erkennt er, daß äußere Einflußfaktoren und Probleme, die mit einer gerechten Einkommensverteilung und dem hohen Monopolisierungsgrad der ungarischen Wirtschaft zusammenhängen, in einigen Bereichen das Weiterbestehen bürokratischer Regelungen unvermeidbar erscheinen lassen, wenn auch in eingeschränkterem Umfang als bisher.

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<sup>1</sup> The author's inaugural address on Apr. 16, 1983 at the Hungarian Academy of Sciences. The author gratefully acknowledges the support of the Institute of Economics, Hungarian Academy of Sciences and the Alexander von Humboldt-Stiftung, German Federal Republic



This paper has two objectives. The first is to raise a few theoretical ideas and outline an analytical framework that can be used for investigating related problems. The second is to make a contribution to the discussion of the economic reform from the viewpoint of the subject indicated in the title.

The paper is a partial product of a longer research.<sup>2</sup> Owing to the restricted space available I shall be forced to discuss great and complicated issues in brief; they will be explained in detail in later publications.

### I. The four mechanisms of coordination

In the paper different *coordination mechanisms* will be confronted with each other. Coordination in the present paper is defined as the regulation of two or several mutually interacting individuals or organizations. Not only the control of the production and trade of economic goods in the everyday sense are included here, but also the regulation of every kind of social transformation and transaction process. Thus, not only coordination of the production and sales of iron or textiles, but also automobile transport and health service are included.

The term *allocation mechanism* may be used as a synonym. Coordination, namely, includes the allocation of the inputs and outputs of the activities.

For the purpose of abstract analysis four pure types will be distinguished.

To distinguish the basic forms of coordination three main characteristics of each will be stressed.

#### 1. *Bureaucratic coordination*<sup>3</sup>

- a. There is a vertical relationship, sub- and superordination between the coordinating individual or organization and the coordinated individuals or organizations. Above the direct bureaucratic control of the microprocesses, there is usually a multi-level hierarchy of sub- and superordinations, which indirectly participate in the coordination.
- b. The individuals and organizations are motivated to accept the orders and prohibitions of the coordinator through administrative coercion supported by legal sanctions. The vertical relationship is lasting and institutionalized; it is mutually acknowledged both "above" and "below".
- c. The transactions are not necessarily monetarized. But if they are, the subordinated individual or organization is financially dependent on its superior.

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<sup>2</sup> I should like to express my thanks here to K. BALOG, M. NAGY and L. HORVATH für their valuable help in the research. I read an earlier version of the paper at the LASZLÓ RAJK college. I am grateful for the remarks and advice of the audience which I exploited in formulating this later version.

<sup>3</sup> There is a vast literature on the scientific investigation of bureaucracy. I only stress a few works which form most of the literary background of the present paper: M. WEBER [16], H. SIMON [15] and W. A. NISKANEN [11], [12] and from the Hungarian literature the works of A. HEGEDÜS [2], [3] and K. KULCSÁT [8].



## 2. *Market coordination*

- a. There is a horizontal relationship between the buyer and seller individual or organization; the two participants are equal from the legal point of view.
- b. The individuals or organizations are motivated by the intention to make profit in terms of money. In its pure form market coordination takes place at free prices based on an agreement between buyer and seller; at prices at which it pays for both parties to sell and buy.
- c. The transactions are monetarized. This is the only form of coordination which is necessarily monetarized.

## 3. *Ethical coordination*

- a. Similarly to market coordination, a horizontal relationship exists between individual organizations.
- b. The actors are not motivated by administrative coercion nor by the intention of making profit in terms of money. Coordination may be based on reciprocity, on expecting mutual help, but it may be one-sidedly altruistic as well. On the level of abstract discussion the question by what moral principles individuals or organizations are motivated will be left open. For a lasting prevalence of this form of coordination it is necessary that it should be fixed by custom or tradition and the underlying principles be raised to morally obligatory norms for the participants.
- c. The transactions are, as a rule, not monetarized, (though there may be exceptions; one of their possible forms is a present made of money).

## 4. *Agressive coordination*

- a. There exists a vertical relationship between a superordinated and one or several subordinated individual(s) or organization(s). To this extent it resembles the Form No. 1.
- b. The motivation is established by force on part of the superordinated towards the subordinated in order to achieve the desired transformation or transaction. This is a wilful force – not acknowledged by law and morality. This is precisely what distinguishes it from Form No. 1.: coercion is not institutionalized. For this reason it is mostly not lasting but of occasional nature.
- c. The transactions may be either monetarized or not.

I will quote two examples to illustrate the four basic forms. One example is coordination of *land use*. Bureaucratic coordination: the state authority allocates the land for the users. Market coordination: the ownership of land or the right to use it is sold and bought for money. Ethical coordination: the occupants of free land voluntarily agree which will be used by whom; or the owner gives the land as a present. Agressive coordination: the land is robbed from the earlier possessor.

The other example is coordination of the *traffic of passenger cars*, that is, allocation of the right to use the road. Bureaucratic coordination: official prescriptions of behaviour on the roads, the observance of which is monitored and enforced by the police. Market coordination: the setting of parking fees or the collection of tolls for the use of the roads. Ethical coordination: the voluntary attention and complaisance of drivers towards other



drivers. Aggressive coordination: the driver wilfully restricts or infringes upon the rights of other drivers: overtaking them by forcing them to sudden braking, "pushing" them from behind etc.

I would add some general remarks to the above classification.

- A considerable part of the literature of the problem classifies the *organizations* according to various criteria and then examines the behaviour of some characteristic type of organization (e. g. the "bureau" or the "enterprise"). In contrast, we are studying *control processes*. Such a coordination mechanism may cover a very wide scope of activities. (E. g. control of all kinds of production and trading activities of the state-owned enterprise in the framework of the mechanism of directive planning.) But it may be narrow, covering some partial area/as the coordination of passenger car traffic just mentioned.
- In our analysis we are discussing not only objects or physical actions and processes, but mainly relationships between people, that is social relationships. The research task to be performed is to elaborate the *political economy of coordination*. I think that our discipline is only at the beginning of coping with this task.
- I have made efforts to provide a *complete classification*<sup>4</sup> with the four basic forms reviewed. The classification is complete in the sense that the direct control of every microprocess is performed by one of the basic forms or by some of their combination.<sup>5</sup>
- Never in history has a society existed in which every activity was coordinated exclusively by one of the four basic forms. The most ancient forms are nos. 4 and 3, but also the basic forms nos. 1 and 2 look back on a long historical past.

In reality the different basic forms operate side by side. Their scope is partly disjunct, but partly they assert themselves more or less closely intertwined. History has already brought about a huge variety of combinations and, parallel to the existing ones, new combinations are continuously coming about.

Frequently, also historical transitions from one basic form to another took place. Form No. 3 may change into Form No. 1: the ethical norms become institutionalized as legal norms, their observance is no longer left to conscience, but is forced by sanctions

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<sup>4</sup> In working out the classification I was inspired by the well-known "integration schemas" of K. POLÁNYI (see [14]). But the classification given here differs from that of POLÁNYI in several essential respects. I only stress the most important deviations: What POLÁNYI calls "redistribution" is mostly related to what I call - in agreement with many other researches - "bureaucratic coordination". Redistribution may take place in the framework of bureaucratic coordination, but this is not the only, not even the most important activity of this form of coordination. By stressing the redistributive role, POLÁNYI not only narrows down the description of this form of coordination, but also distorts its evaluation. In several of his readers - and particularly in the "Polányist" believers - the impression is left that, against the "unjust" market, the "redistribution" secures a more just redistribution. It may be observed that with the adherents of POLÁNYI we find an antipathy towards the market and a sympathy for "redistribution".

Also POLÁNYI's "reciprocity" is a too narrow concept: this is one of the particular - but certainly not general - cases of the basic form No. 3 of ethical coordination.

<sup>5</sup> In order to avoid misunderstandings, this does not mean that the manysided description of some concrete social system or subsystem would be exhausted by telling which basic form of coordination or what combination of these performs the direct control of the microprocesses.



and, together with this change, also the bureaucratic machinery of coercion appears. There also exists another kind of historical transformation: the ethical coordination becomes "commercialized", that is, Form No.3 turns into Form No.2. Thus, the activity is increasingly motivated by financial gain instead by moral command. Or, again another kind of historical transition: Form No.4 changes into Form No.1. The openly willful force becomes institutionalized, it turns into legally sanctioned bureaucratic coercion. But also the reverse exists, when the legally regulated bureaucratic coordination operating in a lawful framework degenerates into open willfulness. Coordination changes from basic Form No.1 into Form No.4.

An important direction of further research is the *historical* and the related *causal* analysis. It has to be clarified which basic form of coordination comes to the fore in what historical situation and under what social conditions together with the proportions, and relative weights with which the basic forms participate in the combinations. The present study does not undertake this historical and causal examination. Instead, we shall restrict ourselves to asking much narrower and more modest questions.

## II. The tenacity of bureaucracy

The first question to which I should like to find an answer is whether the role of the bureaucratic mechanism is growing, stagnating or diminishing in the social coordination of Hungary today. Owing to spatial limitations of this paper, I will not engage in the discussion of the *relative* proportions, and weights of the various mechanisms. I shall restrict myself to examining the *dynamics* of the bureaucratic mechanism.

The scope of bureaucracy is difficult to measure. In Table 1 we make an attempt at characterizing the expansion of bureaucratic coordination with the aid of a few indicators. I make no comments on the individual development of the six kinds of time series. There is some fluctuation. Expansion and restriction do not occur uniformly with the various indicators. Yet it may be established, with global picture presented by the table, that *the series of data show a rather high stability. Nowhere do we find a declining trend; either stagnation, or growth can be experienced. This shows the extreme tenacity of bureaucratic coordination in a historical situation when, as a matter of fact, a deep decentralizing reform process took place.*

I separately stress row 3 of Table 1, which comprises the expenditure on bureaucracy, at unchanged prices, thus eliminating the inflationary effect. Let us confront this with the dynamics of production. The main data are comprised in Table 2. We divided the period for which the data on administrative expenses were available into two subperiods: the years between 1970–1978, before the braking of production, and the years of restriction between 1979–1981.

We all know PARKINSON'S book in which he shows that while the British colonial empire was dwindling the central colonial bureaucracy increased. Table 2 seems to present some kind of Hungarian PARKINSON'S law: While the growth of production radically slowed down, the growth of expenditure on the bureaucratic machinery kept on increasing, it even accelerated somewhat. What caused this tenacity? What is the explanation for the fact that the growth of bureaucracy is an almost irreversible process? Without a claim to completeness, I would stress four explanatory factors.



Table 1: Some indicators of the expansion of bureaucratic coordination

Indicators	Unit of measurement	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	
1	Number of legal orders		319	364	307	382	371	399	386	332	406	431	433	
2	Staff of central organs	heads	10.245	10.791	10.892	10.719	10.721	10.806	11.046	11.012	10.993	10.750	10.699	10.069
3	Administrative expenses of budgetary organs (at constant prices)	million Ft	3 098	3 268	3 462	3 587	3 995	4 221	4 156	4 220	4 369	4 517	4 789	5 049
4	Centralized part of "net income"	per cent	71,5	73,6	73,4	70,4	69,0	69,6	70,2	69,0	70,0	70,9	70,3	
5	Ratio of central government contribution to the own funds in the development fund of the county councils	per cent	427,9	432,9	489,1	489,1	522,9	519,7	736,8	631,9	677,7	666,7	614,1	660,8
6	The ratio of profit-deflection caused <sup>1</sup> by redistribution in state <sup>2</sup> -owned enterprises	per cent						70,2	59,3	53,7	56,4	63,0	65,8	

*Explanation and source of the data:* The data in row 1 were compiled in the Ministry for Justice. See also the article by A. KOVÁCS [7]. – The data in row 2 comprise only the staff of the central organs, but exclude those of the councils. Nor do they include the armed forces. The data were compiled in the Ministry of Finance. – The data in row 3 comprise the administrative expenses of the central organs, plus these of the councils of the capital and of the counties as well as those of the councils of larger cities of county rank. They do not comprise the administrative expenses of the smaller communities (district and town councils etc.), the expenditure on defence, law and justice, nor those spent on social and economic purposes etc. The data at current prices were taken from the budget estimates; the actual figures differ little from these. The source is the budget act on the years in question. The data at current prices were converted to constant prices with the aid of a series of price index numbers received from the Central Statistical Office. It was the series relating to "public consumption" that was used for the purpose. – The source of data in row 4 is the book by KUPA [9] and the data for the last years were complemented by the said author (Institute for Finance Research). – The data in row 5 compare the two sources of receipts of the councils of the capital, the counties and cities of county rank: the central government contribution is divided by the own sources of the councils and expressed in percentages. The source of the data are the budget acts. – The data in row 6 were taken from the material of a research project, conducted by a group of researchers directed by the author. (See the study by KORNAI-MATITS-FERGE [6]). We determined what the profit of a state-owned enterprise would be if no taxes were levied on it and no state subsidies under any title, would be received. This we called "original profit". The data in the table is a quotient: original profit less actually accounted profit per original profit. The indicator shows approximately the relative weight of income redistribution implemented in the scope of state-owned enterprises.



Table 2: The growth rates of output and of administrative expenses in per cent

Period	GDP	Administrative expenses
1970-1978	5.9	4.4
1979-1981	1.4	5.6

Source: The GDP-data were taken from the Statistical Year-books.

For the source of data on administrative expenses see the explanation of row 3 in Table 1. Both series of data were compiled at unchanged prices.

### 1. The inclination of bureaucratic coordination to self-accomplishment

Bureaucracy spans a network of rules in the flow of some social microprocess. If the net is too thin, every kind of irregularity slips through it. The solution is to make the network thicker. We may call this the "inclination to self-accomplishment" of bureaucracy: it is inclined to complement the general regulation again and again with more concrete and detailed rules.

I will quote two examples, the first from the field of price and profit regulation. In 1979 the Ministry of Home Trade issued an order on the so-called "price-risk fund"<sup>6</sup>. The idea was suggested by the practice of the market mechanism. If the conditions of sale demanded it, the trading firm should be in a position to grant a price reduction. The enterprise should form a separate fund from its receipts in order to make up for the receipts lost in consequence of price reduction. The idea is rational, but now comes the bureaucratic regulation of the affair. "What is allowed, is compulsory ...". The formation of the price-risk fund is not only allowed, but even prescribed by order. In fact, it is determined to the minutest detail how much the enterprise is to place into its fund - in percentage of the price receipts. The Trial (trading in toys) 0,8 percent, the Amfora (glassware) 0,7 percent, the Piért (paperware) 0,2 percent, the Ecclesia cooperative (candles, books and painting etc, related to the action practice of the Catholic religion) 0,6 percent, and so forth. Should the fund prove to be too big, it cannot be used to complement profits, but should it be too small, it has to be refilled from profits.

I took the other example from the scope of the financial stimulation of managers. It was in 1980 that the Ministry of Home Trade regulated, by order, the financial incentives of enterprise managers<sup>7</sup>. The order emphasized all kinds of "viewpoints" which should be taken into account in allocating bonuses. Among them we find several concrete "tasks" from the implementation of energy saving regulations through the satisfaction of demands of families with many children and of retired people to the reduction of stocks. The order meticulously determined the lower and upper limits to the bonus coefficients, taking care that the upper limit should be in the "trade in miscellaneous articles" 4,0, while in the commodity leasing enterprises and in the travelling agencies it should be only 3,5.

<sup>6</sup> Order Nr.24/1979 (XII.30) BkM on the price-risk fund.

<sup>7</sup> Order No.12/1980 (VII.15) BkM. on the system of financial incentives of higher enterprise executives.



We surveyed the regulations and orders of several years and can quote dozens of similar examples.

## 2. Extension of bureaucracy to earlier little-regulated fields

If in the preceding section we spoke about the intensive growth of bureaucracy, we shall now pass to discussing its extensive growth. *When the role of bureaucracy is pushed back in some area, its point of emphasis frequently shifts to another field.* The phenomenon resembles the case when the surgeon removes a cancerous tumour at one place of the organism, but in the meantime a metastasis has developed and the proliferation of cancer cells has started in a different place.

The problem appeared clearly after 1968. The mechanism of bureaucratic instruction was eliminated from the direct control of production. True, it steals back again and again. But, and this is even more important, a metastasis has developed in the regulation of enterprise income. The Ministry of Finance made a study on the regulators affecting profit<sup>8</sup>. Accordingly, profit is affected by 228 kinds of so-called regulatory elements (i. e. bureaucratic interference). A dozen of state organs claim the right to give or take, that is, actively interfere with the formation of profit.

## 3. Shortage and administrative allocation

In the case of shortage, when market coordination cannot fulfil its function, the mutual adjustment of demand and supply, either the mechanism No. 4 steps in (might is right ...) or bureaucratic coordination becomes indispensable.

A vicious circle comes about<sup>9</sup>. The bureaucratic regulation unavoidably leads to excessive claims, because the claimants deem to improve their bargaining positions in this manner. Rationing leads to hoarding, i. e. to the swelling of users' stocks. Demand becomes almost limitless – and shortage becomes permanent, if only on this account. In this lasting shortage situation the administrative system of allocation becomes unavoidable – and so forth.

Many examples could be quoted, beginning from the administrative allocation of state-owned flats to some still existing material quotes. A fresh example is the intensification of the shortage of foreign exchange. The bureaucratic regulation of imports from the West and of the use of convertible currencies has suddenly revived and is booming; exports are forced through administrative pressure.

## 4. Interestedness in doing away with bureaucracy

In Hungary everybody is against bureaucracy – and yet this cannot develop into some kind of mass movement. Why not?

It is first of all the apparatus in charge of a certain area that is mainly interested in maintaining bureaucratic coordination in the field under his supervision. This is what

<sup>8</sup> See [13]

<sup>9</sup> On this subject see the book by the author: "Economics of shortage" [5], particularly Chapters 5 and 17.



provides power and prestige, and it rarely occurs that people voluntarily and gladly renounce them. But also those are interested in maintaining bureaucratic coordination who are beneficiaries of its redistributive effect or may expect such effect in the future. Let us consider the example already mentioned, the regulation of enterprise income. It means great power for several state organs that they can provide income to the enterprise or can draw away income from it. Also the enterprises which to some extent draw advantages from the present redistribution or expect to enjoy such favours later are interested in preserving this influence.

There are many advocates of further decentralization and of further increasing the role of market coordination in the circles of economic leadership. However, many of them are adhering to this reform process in such a way, that they advocate the preservation of bureaucratic position *in their own sphere of power only – as an exception to the general rule*. As every economic executive has its own sphere of power, every bureaucratic position has a strong defendant. In addition, those defending their positions can reckon with a mass background of supporters, in the sphere of the actual or prospective beneficiaries of their own reallocation activity. *This is the paradox on the fight for suppressing bureaucracy: in spite of the general anti-bureaucratic feeling great powers are fighting for the preservation of every single bureaucratic position.*

### III. Dispute with three views

Although, as it turned out from the preceding chapter of the paper, the scope of bureaucracy has proved to be stable up to now, there are many – myself included – who believe that we must fight for reducing its role. But opinions are divided as to *how* to fight. I should like to challenge three views.

#### 1. *Neither bureaucracy, nor market?*

After a scientific discussion a young woman sociologist fulminated: "I hate bureaucracy and I hate the market". I assume she does not like aggressive coordination either. It logically follows that she is of the opinion that the mechanism No.3, i.e. ethical coordination, should become dominating.

This is not an exceptional standpoint. In my opinion it is unacceptable in this extreme form. In pre-industrial societies – particularly in the primitive ones – the scope of mechanism No.3 was still much wider. Then the coordination of activities was a much simpler task. Society did not move for a long time, it was stationary, and under such conditions custom, the routine-like repetition of the same activities, and the influence of tradition obtained a greater role. Society was morally much more homogeneous than in recent times.

By now that has all been changed. Owing to technical progress and the much more differentiated division of labour coordination has become much more complicated. The economy and society are undergoing constant and rapid changes, custom and tradition can become less stable. There are deep conflicts between the moral concepts of various social strata and groups. It is not a matter of faith or hope whether under such conditions the mechanism No.3 can play a dominating role. The proposition can be empirically proven that *moral coordination does not – and cannot – play a dominating role in any modern socio-economic system.*



In our age the mechanism No. 3 seems to be rather unstable and transient. In several fields where ethical coordination takes place sooner or later "commercialization" occurs (3→2) or it becomes institutionalized and bureaucratic (3→1), and in the worst case it is ousted by aggressive coordination (3→4). *There is no vacuum in coordination!* Where there is no strong and tough mechanism No. 1 and/or No. 2, and where No. 3 proves to be weak, the mechanism No. 4 will break in.

In my opinion the role of ethical coordination may be restricted to the following:

- It may regulate processes in which neither bureaucracy, nor the market plays – perhaps even cannot play – the main role. E. g. the choosing of a partner (in marriage) is a coordination and allocation process. In our age this is basically regulated by an ethical coordination mechanism, and the other mechanisms perform at most complementary functions. (Obviously, this was not always so in the course of history.)
- It may appear also in combinations, as complementary to the mechanisms Nos. 1 and 2 as main coordinators. In the best case, it may achieve that bureaucracy or the market should be "honest".

As long as not more is expected of the ethical coordination, it deserves the warmest support. It is necessary that the family, the school and the media should invoke unselfishness, voluntary adjustment and attention to our fellow-beings<sup>10</sup>. It deserves, however, quite different judgement, if somebody expects more than that and believes – and makes others believe – that the control of production can be based, massively and generally, on ethical coordination. This is naive Don-Quixotism, which is usually associated with a nostalgic desire for past "more ethical", "more community-minded" ages. In the final analysis these naive views may even have harmful effects, because they prevent people from facing the true dilemma: what role to give to mechanisms Nos. 1 and 2, to bureaucracy and to the market. These and only these are the really strong and weighty alternatives<sup>11</sup>.

## 2. Complete elimination of bureaucracy?

As a representative of the second view I shall quote myself from 26 years ago. At that time an article of mine was published under the title "Let us uproot bureaucracy"<sup>12</sup>. Many believe so even today. This, too, is an extreme and naive view. As for myself, today I already am of the opinion that it does not hold water.

The great virtues of the market are well-known. It provides a sensitive information system. And stimulation is automatically linked to information: not only positive stimulation rewarding success, but also a negative one punishing poor performance. Who does not adjust, and does not economize, will be sooner or later eliminated by market competition. It is particularly important that the buyer has great influence on the market, the producer and the seller are forced to heed the demand of the buyer.

All that, notwithstanding, the market coordination also has great deficiencies. There are several such functions of coordination in which the market fails. These are common-

<sup>10</sup> This is what, among other things, E. HANKISS has had in mind in his study [1] when he calls attention to the importance of "behavioural culture".

<sup>11</sup> This point came up also in the disputes with the New Left in the West. See A. LINDBECK's well-known book [10].

<sup>12</sup> See [4]



ly known, and, precisely, on this account there is a social demand for the elimination of market failures. Together with that, *there also exists a social demand for applying bureaucratic coordination*. This social demand, too, keeps bureaucracy alive, not merely the tenacious clinging of bureaucrats themselves to their own influence. This is so in the capitalist market economy and this social demand asserts itself even more in the socialist socioeconomic system. Without a claim to completeness I shall emphasize three issues in this context.

The first is *the deficiencies of the market in performing economic coordination*. Some activities may have detrimental qualities which the market does not account among the costs, and others produce social benefits which are not accounted among the receipts. This is the well-known problem of *externalities*. In such cases interference through bureaucratic control is mostly unavoidable. Prohibitive administrative regulations or officially levied deterring taxes are needed in order that the participants in economic life restrict their activities entailing unfavourable external effects. Similarly, actions entailing favourable external effects can be stimulated by officially regulated financial advantages, e.g. tax rabates.

A related problem is that of *transaction costs*. The coordination of the use of highways might be solved, as a matter of fact, by taking tolls at every corner from those actually using that way. But this "pure" market solution would be very inconvenient and expensive. In this case the bureaucratic solution is more advantageous: the owners of cars pay taxes and the maintenance of the road network is covered from tax income as a free service. The market solution is also circumstantial in several other cases and involves prohibitive transaction costs, while the bureaucratic solution may prove to be cheaper.

Another important issue: *the deficiencies of the market in securing a fair distribution of income*. The market differentiates incomes in a manner that it necessarily infringes upon the moral principles relating to just distribution of income. It may bring about such extent of inequality which is no longer needed for stimulation to better performance. Such high incomes emerge behind which we do not find satisfactory socially useful performance, merely good fortune, inheritance etc. And conversely, low incomes exist which cannot be attributed to the lack of industry, but to inherited unfavourable conditions or other misfortune.

For developing more just income proportions taxes, subsidies, welfare payments and other interferences serving redistribution are necessary and for their implementation a bureaucratic machinery is needed. The stronger the claim on redistribution, the greater the role of the bureaucratic machinery will be.

Finally, a third issue is related to *the monopolies*. Development of the productive forces entails the specialization and concentration of production and this unavoidable leads to the emergence of monopolies. An accompanying phenomenon of this historical process is the appearance of social demand for the restriction of monopolistic power. Bureaucratic organizations come about for the purpose of controlling the monopolis or they are nationalized, or their functions are taken over by bureaucratic institutions<sup>13</sup>.

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<sup>13</sup> In a socialist economy this kind of tendency to bureaucratization is further strengthened by the artificial creation of monopolistic enterprises (through amalgamation of enterprises, elimination of overlappings in "production-profiles", making some enterprises fully responsible for the supply of



To sum up: *bureaucracy cannot be uprooted because – above a certain level of development of productive forces – its roots are found in social existence itself.* The troubles with the other coordination mechanisms make the appearance of bureaucracy unavoidable by themselves. To remain with the example of the “tree and the wood”, we have to rest satisfied with more modest aims: the trees of bureaucracy should not grow to the skies, it should not proliferate like a jungle.

### 3. *A harmonious symbiosis of the market and bureaucracy?*

The third view I should like to challenge is a simplification of the symbiosis of market and bureaucracy. The advocates of this view usually rest satisfied with such stereotypes as: let the “government-regulated market” or the “planned regulated market” function. But this is easier to wish, to proclaim as a slogan in fully general terms than to actually implement.

The market and bureaucracy are not gin and tonic that can be mixed in any proportion wanted. There may be a certain level of bureaucratic market restrictions which still allows breath for the market. But beyond a critical limit bureaucratic restriction cools down the live forces of the market, kills them – and only the appearance of a market remains. And there exists such combination of market and bureaucracy which unites, as it were, only the disadvantages of the two, while the separately existing advantages of both get lost.

For an example I should like to quote the prices adjusting to world market prices, the so-called “competitive price system” introduced in Hungary. The basic order was issued in November, 1979. Since then, until April 1983, 14 orders have been issued which complement, modify or interpret the original, that is, one each 2 or 3 months. But, so it seems, there always remains something requiring new regulation. Let us have a look at a concrete order, that of April, 1981<sup>14</sup>. On a real market it depends on the horizontal relationship between seller and buyer and determined by the relation of supply to demand to which buyer the seller will sell the commodity and at what price. As against that, the order quoted interferes with this process in a vertical manner. The original order wished to adjust the price that can be charged on the domestic market to the external market price. The modification provides exemption from this rule under definite conditions. It establishes that the producer needs to reduce the price level of domestic sales even if the profitability or price level of the non-rouble exports diminished insofar as the following conditions are met:

- the ratio of non-rouble exports is 5–12 per cent of domestic sales and non-rouble exports have grown by 10 per cent, or
- the ratio of non-rouble exports is 12–15 per cent of domestic sales and non-rouble exports have grown by 8 per cent, or

certain goods, etc.). In an officially created and protected monopolistic situation also the behaviour of the enterprise develops accordingly: it behaves as if it were an “authority”; it dictates its partners, distributes administrative allocations and so forth.

<sup>14</sup> Order No. 13/1981 (IV.18) AH of the chairman of the National Office for Materials and Prices, on the modification of the order No. 6/1979 (XI.1) AH on the price formation adjusting to foreign economic prices.



– the ratio of non-rouble exports exceeds 25 per cent and non-rouble exports have grown by 6 per cent.

It seems that these ratios have not stood the test. A few months later a modification of the modification was issued<sup>15</sup>. The earlier critical values of 10–8–6 per cent have been now replaced by 8–6–4 per cent. Why exactly 8–6–4 per cent? Why not double or half these values? And has the sales price on the domestic market nothing to do with the state of the domestic market at any time?

These two orders are typical examples of bureaucratic market restriction. The price system adjusting to world market prices is usually characterized by its advocates by saying that in this case it is the office that simulates the market. The situation rather reminds me of female impersonators. The superficial viewer may have the first impression that he sees a woman, while in reality the one he sees is not a woman exactly in the most distinctive characteristics. This alleged simulation of the market differs from the real market in the most important and most advantageous feature of the latter: that the seller depends on the buyer (and not on the office).

The example we have reviewed is not simply a vicious circle in the relationship of the market and bureaucracy. More aptly, we may speak about a whirlpool, the *whirlpool of bureaucratic market restrictions*. The more frequent, clumsy and mechanical the interference, the poorer the operation of the market. Thus, the authority increasingly feels it has to intervene more frequently and in greater detail – in response to which the market will operate even more poorly and so forth. The bureaucratic restriction of the market deepens and, in the final analysis, the market becomes atrophied.

From what has been said two normative viewpoints follow. One is that in several fields it is more expedient to separate than to mingle the roles of the market and of bureaucracy. In many cases it can be clearly and unambiguously separated so that the control of some process should only be performed by mechanism No. 1, and that of another one by mechanism No. 2. The other normative viewpoint: if a combination becomes unavoidable, the two mechanisms should be “let together” with caution. In most cases, a 50–50 proportion is not necessarily an ideal compromise. One of the forms should remain dominating, and the other should do the correcting and complementing.

#### IV. Concluding remarks

Having reached the end of this paper, I should like to make a few rather personal remarks. Bureaucracy is a popular topic, and is suited for declarations with strong emotional content. As far as possible, I have made efforts to remain rather objective.

I should like to join the ranks of those who wish to reduce substantially the scope of bureaucracy – but I join the fight without overheated expectations. On the one hand, the chances are not too heartening. I have discussed in detail how tenacious bureaucracy is, and how strong the resistance is to the pulling down of power positions. In spite of this, the effort is not in vain. At any rate, I do not want to make my own standpoint depen-

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<sup>15</sup> Order No. 24/1981 (XI.26) AH of the chairman of the National Office for Materials and Prices on the modification of the order No. 6/1979 (XI.1) AH about the price formation adjusting to foreign trade pieces.



dent on the chances of either acceptance or of success. On the other hand, we cannot have illusions that the market, the only serious rival of bureaucratic coordination, could perfectly regulate the socio-economic processes.

In spite of all this, I am of the opinion that *there are many fields in which the market mechanism could provide more advantages than disadvantages. This is why it is necessary and worth our while to work on the substantial suppression of bureaucratic coordination and on the expansion of market coordination.*

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