

A Review of János Kornai's *By Force of Thought: Irregular Memoirs of an Intellectual Journey*

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This article reviews the memoirs of János Kornai. The famous Hungarian economist describes his life experiences and the concurrent history of Hungary. More importantly, he leads us through his intellectual evolution, explaining how his thinking evolved, how it was influenced by events, how one research question led to another. This brings alive the intellectual and historical developments that led to Kornai's work on socialist incentives, on the theory of planning, on the economics of shortage, and on the transition from socialism to capitalism. The book takes us on a journey that encompasses large elements of the history of economic thought in the second half of the twentieth century, as well as the history of Central Europe.

Famous economists rarely write their memoirs. We are thus exceptionally blessed to be able to read the book length memoirs of János Kornai—*By Force of Thought: Irregular Memoirs of an Intellectual Journey* (MIT Press, 2006). In this 461 page book, the reader gets an exceptional insight into Kornai's life, which has been inextricably linked with the history of Hungary, starting with World War II, through the Soviet domination, the 1956 uprising, the economic reforms under “Gulash communism,” and finally the transition and the entry into the European Union. We also get an exceptional insight into the intellectual evolution of the famous Hungarian economist. Kornai is, to this date, the only economist who has ever come up with a complete positive theory of the socialist economy—explaining how it

worked, why it did not collapse despite the absence of markets, and also why it was characterized by chronic shortages and inefficiencies. While he is well known throughout the profession for his concept of the “soft budget constraint,” he has had an enormous intellectual influence on those in China, Russia, and Central Europe who wanted to contribute in one way or another to the process of transition from socialism to capitalism. The autobiography of Kornai, one of the most influential economists of the twentieth century, should be read by those who are interested in economics and also in the history and intellectual developments of the twentieth century. It is not a coincidence that the English translation was published by MIT Press. This is really an intellectual autobiography. It is obviously an intellectually unique source on Kornai as well as a contribution to the history of economic thought. Having read

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most of his books myself, it was interesting to read his perspective on them.

Born in 1928 into an educated Budapest Jewish family, Kornai went to a German school and grew up bilingual, as was the case with so many intellectuals in Central Europe at the time. His father, a lawyer who had represented the interest of German firms in Hungary, started losing clients when Hitler came to power and was loaded on a train to Auschwitz. By the time he was sixteen in 1944, he had lost his father and his oldest brother and had barely escaped death himself. Only one in three Hungarian Jews survived World War II.

Given the trauma of the War and the crucial role played by the Soviet Union in defeating the Nazi regime, Kornai, like many other members of the Jewish intelligentsia, became a Communist. He describes aptly and with great subtlety the different stages of identification with Communism—sympathizer, party member, active party member, true communist, and professional party worker—and how he went through these different stages. His rendition of the impression that reading Karl Marx and György Lukacs made on him as a young man is a great read. At the age of nineteen, he became a journalist for *Szabad Nép*, the central daily newspaper of the Communist party. He worked there as an economic journalist and gathered first hand experience of how the planned economy really worked. He explains nevertheless how his blind faith in communism distorted his understanding of the economic inefficiencies he observed: he attributed them to lack of discipline and lack of awareness for the general interest. His world view was shattered in 1954 when meeting Sandor Haraszti, a respected party leader after World War II. Haraszti had been arrested in 1950 as part of what came to be known as the Rajk trials (a Moscow-trial style Stalinist purge was organized in the early 1950s in the satellite countries leading to the execution or imprisonment of various communist leaders). The old man explained to Kornai

how he had been tortured to confess to fabricated charges. Kornai became gradually disillusioned. He was later dismissed from *Szabad Nép* with other journalists for having criticized the existing Stalinist leadership and became a researcher at the Institute of Economics of the Hungarian Academy of Sciences in 1955.

It is at the Hungarian Academy of Sciences that he broke with Marxism and wrote his Ph.D., which was later published under the title *Overcentralization in Economic Administration* (English translation, Oxford, 1958). Despite having no Western training in economics at the time, the book displayed Kornai's acute sense of observation and his ability to formulate theoretical propositions by systematizing his observations. For those who have read it, the thesis contained sharp observations about the incentive effects of plan indicators: the perverse effects of quantity indicators, the neglect of cost, bargaining for lower plan targets, the ratchet effect (avoidance of too large plan overfulfillment), shortage and irregularity of production, and many of the typical characteristics of the planned economy. This was one of the first books to shed light on how the planned economy really worked, together with other pioneering work of the 1950s by David Granick, Joseph Berliner, Alec Nove, and Gregory Grossman. The actual dissertation defense took place only one month before the revolution of 1956 and was a big intellectual event in Budapest. Even though the book did not draw conclusions about the system as such, it described the reality of central planning in a fresh and critical way and did not contain any Marxist jargon. As a rule, Marxists never wrote about the reality of central planning but engaged in Byzantine discussions on whether "the law of value" existed under socialism. With the repression of the revolution, the public success he had received with this thesis made him a target for the communist regime. He lost his job and survived for many years on obscure jobs at the Light Industry Planning

Bureau and the Textile Industry Research Institute.

Between 1958 and 1967, these jobs left him sufficient time to study economics and do research. He studied by himself modern economics and educated himself in mathematical economics. He started working with a mathematician, Tamás Lipták, who helped him and with whom he did research on mathematical planning, a field that was then very active in the West and to which famous authors like Kenneth Arrow, Leonid Hurwicz, Edmond Malinvaud, and Martin Weitzman contributed. Their joint article “Two-Level Planning,” which provided a decomposition method for the solution of a planning model (the transformation of a large linear programming model into subproblems with the center sending quantity signals and firms or sectors sending back shadow prices), was published in *Econometrica* in 1965 and became an instant hit in the economics profession. Kornai started getting invitations to give talks in the West and became quickly acquainted with the top economists of the time, including Arrow, Hurwicz, Tjalling Koopmans, and Malinvaud. In a way, he benefited from the more liberal attitude of Hungarian authorities who let him travel, albeit at the cost of long bureaucratic procedures to receive permission to travel to the West. Scientists from many other socialist countries did not have that opportunity. As one could expect, in his travels to the West, he was usually spied upon by the Hungarian secret police. I have heard Hungarian intellectuals say several times that Kornai was “lucky” to have been isolated by the regime because this left him time to become a famous academic. Needless to say, nearly all of those who were repressed did not become famous academics.

In the 1960s, economic theory considered the market economy and central planning to be equivalent, at least seen through the prism of general equilibrium theory. This is at least the interpretation that one could make on the basis of the two welfare theorems of general

equilibrium theory. Work on general equilibrium theory and on models of planning were quite close, often done by the same people. These were theories of perfect markets and of perfect planning, but Kornai was all too aware that the reality of economic planning was very far away from the theory of perfect planning. He was also quite aware of the real differences between the two economic systems, in particular the tendency toward chronic shortage in planned economies and the tendency toward excess supply in market economies. He became increasingly dissatisfied with this state of affairs. This led him to write *Anti-Equilibrium* published in 1971 which, with its manifest-style title, is both an informed critique of general equilibrium theory (it was a useful companion reading to students following general equilibrium classes in the 1970s) and an attempt to introduce models of the informational sphere of the economy. The critique was widely read and debated but the approach taken in the book did not bear fruit and this disappointed him. He spends many pages in *By Force of Thought* pondering over what he did wrong in *Anti-Equilibrium* and making reflections on the logic of scientific progress.

Having been readmitted to the Institute of Economics in 1967 and admitted to the Academy of Sciences in 1976 despite his lack of adherence to Marxism–Leninism, he spent many years doing research and preparing for what would be his magnum opus, the two-volume book entitled *Economics of Shortage*, which appeared in 1980. As we know, this is the most complete positive theory of the socialist economy that has been produced to date and it is quite likely that this is how it will be perceived by history. It is in this book that he advanced the concept of soft budget constraint and used it to explain the prevalence of chronic shortages in the socialist economy. The softening of budget constraints of firms tends to increase their demand for inputs, labor, and capital. It also tends to make this demand insensitive to prices. As a result, resource constraints must

impose themselves and this takes the form of shortage. The book analyzes in great detail how economic agents (consumers and firms) adjust to shortages in the short term, medium term, and long term. While performing this analysis, Kornai manages to deduce in a comprehensive way all the major phenomena that were associated with the socialist economy: mediocre quality, waste, lack of innovation, bad labor discipline, investment cycles, etc. He also explains the psychology of consumers, managers, and workers having to live in such an economic environment and the choices they make in that environment. He uses these micro-foundations to analyze how the different forms of adjustment to shortage in the economy contribute to avoid chaos and too large disequilibria. Glossing over the table of contents of the book shows how systematic and comprehensive his approach was. He was president of the Econometric Society in 1978 and his presidential lecture, published in *Econometrica* in 1979, gave a short overview of some of his analysis. *Economics of Shortage* had an enormous influence at the time. Those doing research on the socialist economy saw immediately that this was a very fundamental work. The analysis had very important repercussions on the thinking of economists living in Central and Eastern Europe. It certainly had an enormous influence on the reformers and the generation of economists who would be active in the transition from socialism to capitalism. The analysis was not only impressive by its comprehensiveness. It contributed strongly to the rejection among economists of partial reforms of the socialist economy. Reforms aiming at giving state enterprises more autonomy and introducing market mechanisms (so-called market socialism) would not change the system. Soft budget constraints would kill any form of market discipline. Kornai, who was living in Hungary, could not speak quite freely and he did not explicitly draw these conclusions. Nor did he explain where soft budget constraints came from apart from a deliberately vague reference to paternalism

of the authorities. Surprisingly, he spends quite a few pages in his memoirs explaining why lack of freedom of speech prevented him from tracing soft budget constraints back to Communist party rule and state ownership. The reader at the time however understood clearly and could read between the pages. Kornai devotes only a few pages to the content of *Economics of Shortage* but describes in more detail how the concept of soft budget constraint emerged and became popular in economics.

Following the publication of *Economics of Shortage*, he received offers from Harvard, Stanford, the London School of Economics, and UCLA—and eventually chose Harvard. He chose to come only half time, though, so that he could go back every other year to Hungary. He describes vividly the campus life and makes fine and subtle observations about the differences in behavior between Hungarians and Americans in everyday life, ways to greet each other, norms of conversation, norms for dinner invitations, and conversation among academics. It was at Harvard that he wrote *The Socialist System*, a complete synthesis of his analysis of the socialist system. Here, he was completely free from self-censorship and could put the dictatorship of the communist party at the heart of the analysis of the system. The book appeared in 1992. It generated less excitement than *Economics of Shortage* because by then the transition process from socialism to capitalism was in full speed. Nevertheless, the synthesis exists and is there for all those who in the future will want to better understand the internal logic of the socialist system.

Nobody better than Kornai was prepared to think about the coming economic reforms. His book, *The Road to a Free Economy*, which contains his views on transition policies, came out in Hungary in November 1989—the same month the Berlin Wall was being pulled down. The reforms that started in the Soviet Union during 1986–87 by the new leader Mikhail Gorbachev were completely unheard of in a communist system.

Even though they were limited, the glasnost (transparency) campaign created an atmosphere of freedom of expression that had been unthinkable before under Communism. There was the feeling that very important changes were ahead. Big changes were brewing in Hungary also. A Roundtable started to be organized between the party in power, opposition groups, and representatives of civil society. Similar changes were happening in Poland. Kornai was invited to give a lecture on his recommendations for change and the ideas of that lecture became the basis for the book. The stress of the events caused an acute lumbago and he had to stay several weeks in bed. It is from his bed that he dictated the short book, which was published in record time. The title echoed Friedrich Hayek's classic book *The Road to Serfdom*. The book condemned any ideas to further reform socialism, even with simulated capital markets. There was no third road and only a transition to capitalism with private ownership as the main form of ownership would bring genuine economic change. The book also took a decisive position in favor of gradual privatization and against schemes of mass privatization. He emphasized the need for an organic development of the private sector and the gradual development of a middle class. He was very skeptical that socialist economies could be privatized by "cavalry attack." His views won the day in Hungary but not in Russia and Czechoslovakia. Mass privatization led to many scandals, a great concentration of wealth in the hand of oligarchs, little if any efficiency improvements, lack of legitimacy for private property, and eventual forms of backlash.

Kornai spent most of the 1990s writing policy papers on the Hungarian situation: the macroeconomic imbalances of the early 1990s, reform of the welfare state, monetary policy, and other issues. While actively participating to the important policy forums on transition, he became a member of Collegium Budapest, a wonderful Institute in the spirit of the Institute for Advanced Studies of

Princeton or the Center for Advanced Studies in Behavioral Science in Stanford, where he put together several projects, including one on "Honesty and Trust" analyzing the evolution of social norms in the transition countries. After writing this autobiography near the age of eighty, he is still active.

I have emphasized the positive aspects of the evolution of his thought. The book is also a great source on the diverse shortcomings of his own work. He writes in a very lucid way on what was missing in his work. His thesis lacked theory and did not contain a systematic analysis of the phenomena described of the socialist economy. It also lacked clear ideas as to how to overcome the phenomena he was describing. Breaking with Marxism, he was keen to be close to reality and this gave *Overcentralization* a very inductive approach. He considers that his criticism of general equilibrium theory in *Anti-Equilibrium* was partly wrong in criticizing the theory as too abstract. He should have criticized its incorrect use by mainstream economics and, in particular, its abuse in formulating policy conclusions. As I already explained, he deliberately chose self-censorship in *Economics of Shortage* and explains at length both his moral dilemma (he could have published the book as a samizdat but would have had many fewer readers) and the essential parts of the analysis that he left out (the role of the communist party and its control over all economic assets). While his insights on privatization proved to be correct, he nevertheless bluntly admits that he did not predict the large output fall that occurred following price liberalization. Nobody else had predicted the output fall but few economists wrote publicly about the wrong predictions or policy prescriptions they made in the transition process. They all moved on and started working on other topics.

Kornai's life is closely intertwined with arguably the three most important events of the twentieth century: Nazism, the transition to communism, and the transition from communism. He suffered greatly from the

first two, became the world's best analyst of the second, and played an important role in the third. This autobiography is intensely personal in that it relates his life as closely associated to the history of Hungary of the last seventy years. Kornai is not a nationalist but he always chose to stay in Hungary. He chose to stay after the repression of the Hungarian revolution (his best friend Peter Kende went to France where he became a well known political scientist). He chose to be an academic, producer of ideas rather than a policy intellectual, preferring the freedom to think to the lure of power and influence. His academic interests and choice of research topics were, however, always deeply rooted in the Hungarian reality, be it that of socialism, attempts to reform it, or the great transition to capitalism. Kornai explains the different choices he made and it is evident in reading

the book that he stayed consistent with them. These were very respectable choices made by an independent mind. I also think that it is clear that the world has benefited from these choices.

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