

János Kornai

*Contradictions
and Dilemmas*

Studies on the Socialist
Economy and Society

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**Studies on
the Socialist Economy
and Society**

**by
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Preface to the American Edition

This book is the translation of a volume published originally in the Hungarian language. It is addressed not only to the professional academic economist, but also to the general reader. The essays are therefore written in a style accessible to a wider set of readers interested in the issues of socialism and system comparison.

The volume sold out in my country within a few weeks. Perhaps this is because the Hungarian reader, even if he does not agree with the author's conclusions, is surely tormented by the contradictions and dilemmas discussed in the book. He knows the issues analyzed in these essays from first-hand experience. I view with some trepidation the issuing of an American edition. Will American readers, without the same first-hand experience and with a different historical and cultural tradition, be interested at all? Should they be?

One motivation for reading the book can be intellectual and political curiosity. There are now 27 socialist countries in the world: all together 1.7 billion people live under this political and economic system. No one can be indifferent to the state of affairs in socialist economies. This small volume of seven essays does not aim at a broad description and analysis of socialist systems; this ambitious task is left to monographs. But it tries to throw some light on a few important characteristics of social economies. Gathered here then are the observations of an inside witness, one who tries to be as frank and impartial as possible.

The essays distinguish the "classical" or "traditional" form of a highly centralized socialist economy from a system that is in the process of institutional reforms. On the cover of the Hungarian edition a test tube is shown and in the tube there is the map of Hungary. Yes—Hungary is in a state of permanent experimentation. It is a guinea pig of history—How far can the renewal of a socialist economy

go? The experiment has proceeded for some 28 years now. Friends and enemies of socialism must be equally interested to learn about the experiences of the reform. This book does not give a straightforward answer to the ultimate questions of reformed socialism, but at least it tries to offer some critical analyses.

Although the volume's focus is on socialist systems, a recurrent theme is comparison between socialist and capitalist systems, sellers' and buyers' markets, centralized and decentralized management. I hope this book will provide some food for thought and help the American reader to understand the deep differences and also to discover the similarities and analogies between the systems.

As for the differences, the pure models of classical capitalism and classical socialism are symmetrically antithetical: for instance, private versus public ownership, decentralized versus centralized decision-making associated with characteristic dichotomous consequences, the predominant role of price signals versus the predominant role of non-price signals, the buyers' versus the sellers' market, and so on. Real modern societies are, however, different from the pure models of theory. They are combinations and mixtures of the features listed above. Therefore quite a few phenomena which occur widely and intensively in socialist countries also appear in the highly developed industrial market economies and in the non-socialist Third World countries, at least in some segments of the system and to a certain degree. Let me mention three issues discussed in this book: shortages, the paternalistic role of the state vis-à-vis weak producers, and bureaucratic management. I wonder whether these are topics completely unfamiliar to the American reader? He experienced shortages and rationing during the World Wars, and more recently, and briefly, during the oil shocks of the 1970s. Today in some sectors—rent-controlled housing and in some areas of the health services, for instance—there can be a certain deficit of resources. The American reader is also a regular witness to political struggles; lobbying and pressuring for and against the paternalistic role of the state in supporting and sheltering ailing sectors and weak producers. As for bureaucratic control and expandable, “soft” budget constraint, there are the well-known stories of defense expenditures, military investments, and federal and local subsidization of other bureaucratic organizations. I do not want to overrate the similarities,

or the differences. The aim of these essays is just to stimulate comparative thinking.

I am aware that all generalizations about citizens of a particular country are inevitably superficial. Nevertheless I am risking just that in confronting a rather typical American and Hungarian attitude. Many Americans in public life and politics, as well as in the academic world, have a very deeply embedded belief: that every problem has a solution. Many Hungarians, at least in intellectual circles, do not share this belief. Not because we know it better from mathematics, which provides many examples of unsolvable problems; rather it is more a question of *Weltanschauung* generated by historical and cultural tradition. There are unsolvable dilemmas, because each of us has conflicting goals and adheres to conflicting ethical postulates. This volume contains essays on such issues. Life, of course, produces pragmatic compromises, and rightly so—but at least we should bravely face the dilemma, before turning to the compromise.

Optimism is the “official party line” in the United States, to use the language of my country. I must warn the reader: this is not an optimistic book. But neither is it pessimistic. There has been a Hungarian tradition for centuries: you are resigned or desperate or angry and a happy outlook is uncertain or improbable—and yet, you work hard and honestly for improvement. Those who have read classics of Hungarian drama or poetry (some are translated into English), or have listened to Bartók’s music, will know exactly this contradictory mood. Perhaps a member of a gray and nonphilosophical profession, like that of the economist, can follow the same tradition. Without presenting rosy, utopian prospects, without pretending to know all the optimal solutions, and without hoping for a great breakthrough in the near future, one may still advocate and promote changes for the better.

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April 1985

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Introduction*

What is common to the seven studies¹ which make up this volume? First of all, that they have been written by an economist, but *not merely for economists*.² They are addressed to all who are interested in economic problems and concerned about social matters. I hope that sociologists, historians, philosophers, lawyers, engineers and officials of political and social organizations will find in them a message worth thinking about.

The *subjects* of the studies have several elements in common. I am mainly concerned with the observation of the *socialist economy* whose functioning I wish to understand and explain. Not the functioning of any *imaginary* socialism, of the kind the first pioneers wished to see or biased propagandists and equally biased counter-propagandists wished to be seen. What I would like to understand is the living *reality* around us.

In my research work I often use the methods of deductive thinking: mathematical models, hypotheses put in an exact form and conclusions deduced strictly from them. But theoretical thinking draws its ultimate inspiration from a generalization of everyday experience. I should be glad if the reader were to sense this in the description of everyday phenomena in this little book: housewives running after articles in short supply, managers begging for subsidies and several other well-known forms of behaviour in economic life. The “regularities” of a socialist economy are not manifestations of normative postulates (the maximum satisfaction of needs, etc.); instead they

* I wish to express my thanks to all those who have helped in publishing this book: the editors, András Nagy Jr, Magda Benczédi, Katalin Farkas and László Boros, and the translators, Ilona Lukács, Julianna Partl, Brian McLean, and György Hajdú. I am very grateful for their attention and care.

are revealed in the behaviour of individuals, groups and organizations. Creating economic theory consists primarily of formulating these regularities exactly and then so combining them as to build up a homogeneous theoretical system, and of elaborating upon certain statements whose truth must be verified. Moreover the criterion for verification is not whether we like a regularity but whether that regularity corresponds with experience.

Comparison is of great assistance in recognizing the specific marks of a socialist economy. Almost all the studies in this book avail themselves of this technique of analysis; some have been written with the express purpose of providing a conceptual system and analytical viewpoints by which systems can be compared. Comparisons have been drawn between the variants of the socialist system (for example, the economy before and after the reform) and between the socialist and capitalist systems. Other dimensions and projections have also been compared. However self-evident the need for comparison may seem, the method is not frequently used in economic theory today. Most researchers specialize in examining a particular system or subsystem. A research economist undertaking to compare systems must be prepared to work out new theoretical categories and cope with serious methodological difficulties instead of using ready-made schemes. Struggles with theoretical and methodological problems are certainly noticeable in the studies included in the present book, and this may cause difficulty to the reader, although it may arouse his intellectual curiosity as well.

The seven studies also share a common *approach*. This has several features, of course. Here I shall mention only the two viewpoints to which attention is also drawn in the title of the book. First, stress is laid on the analysis of the *contradictions* of society, and within society, of the economy. Clearly that is no new discovery. We have all learnt since our schooldays that reality is full of contradictions. The difficulty begins when one takes this thesis, which has grown into a commonplace, seriously and starts to apply it to the examination of our own system. Again in this respect distinctions are worth making. Even orthodox theory admits the existence of contradictions in socialist society arising because the socialist present contains remnants of the capitalist past or the socialist system is surrounded by a capitalist environment. Of course it is still easier to admit the existence of

eternal conflicts arising out of the struggles of human society with nature, or the growth and differentiation of needs as the productive forces develop, while the resources available are always scarce by comparison, and so on. These latter types of conflicts have existed and will continue to exist in all periods and under all systems. The conflicts alluded to are touched upon in several places in the book, but attention is centred on the conflicts *generated by socialism itself*. We have the specific intellectual and public task of analysing the nature of the specific conflicts that arise here and only here. That is a task no one else can accomplish in our stead.

By "we" I mean first a wider circle: economists who live in any part of the world under a socialist economic system that allows them a profound insight into how such a system functions. Secondly, I mean to lay particular emphasis on the role of *Hungarian* economists. Due to a number of historical circumstances, we are in a fairly good position to indulge in plain speaking and express critical opinions. Moreover Hungary is in the forefront of experimentation with new economic methods, institutions and mechanisms. Hungary as a laboratory of the history of socialism deserves attention from the outside world, which can perceive as much as filters through the laboratory walls or as much as can be appreciated on a superficial visit. We, economists, are the ones who stand right by the test-tubes. The kinds of experiments carried out, or the timing of them, does not depend on us (although we may exert a degree of influence), but we can at least see at a close range what is taking place in the intricate system of a thousand vessels and pipes, what the instruments and not least the living objects of the experiment indicate.

Quite a few examples are cited in the book of special system-specific conflicts in the socialist economy. The same process that guarantees full employment generates both a shortage of labour and unemployment on the job. The same mechanism that ensures swift economic growth will lead in the long term to phenomena of shortage, to frictions in adjustment and ultimately to the hindrance of growth. Paternalism and a guarantee of the firm's survival are the two aspects of the same phenomenon. Such conflicts do not stem from the faults of a particular manager, from bad planning or a bad style of work. The cause lies deeper than those, in the power structure of society and the form of ownership and institutional system in it. The social sciences

have an obligation to face up to all these conflicts and reveal the explanations for them. That is the only way in which they can be combated. (Of course it remains true that new conflicts will then be created.) I have learnt from Marx that the science of socialism must be distinguished from Utopia. Neither deductive logic that starts out from realistic assumptions nor historical experience seem to confirm that we are progressing toward a perfect contradiction-free society. The growing forces of production, technical progress and the transformation of the social conditions may on the one hand improve people's lives and produce important historical achievements, but on the other they may give birth to new conflicts and upheavals, new joys and new miseries.

Here we arrive at the other expression in the title of the book: *dilemmas*. How comfortable it would be if there were only a single path before us, as the adherents of mechanical determinism imagine, or, since we have to choose, if we at least had an accurate compass, an optimum-criterion which was acceptable and even attractive to all, and which told us which path to follow—as the adherents of economy-wide “optimization” consider. Real life, however, places those who must make decisions on matters of greater or lesser importance in a far less comfortable position. “If you choose this, it will be good from a certain point of view, but from another point of view it will be bad.” If reality involves contradictions, a decision-maker must inevitably face dilemmas, and that is how the two expressions in the title of this book relate to one another. This thought runs through all the studies like a guiding strand. What I have undertaken to do is not to gloss over the conflicts or reassuringly resolve the dilemmas. I have tried to trace “small” contradictions that show up on the surface back to “big” contradictions hidden in the depths (and even this has been extremely difficult). Thereby I have also tried to trace small, everyday dilemmas back to choices between ultimate values. In everyday economic affairs in the strict sense, such as subsidies for health and housing services or the salaries and bonuses of business executives, are concealed fundamental dilemmas: the conflict between demands that can be made on society and obligations towards society, between security and the stimulation of performance, and a number of other, graver political, social and ethical problems.

The reader of this little book will receive no reassuring answers to his questions. These studies can at the most help him to formulate his questions.

November 1982

NOTES

¹ All the studies in this book were published previously, between 1978 and 1982. Only a few small changes have been made in the texts as previously printed, mainly with a view to avoid overlap. (Even so, a certain amount of overlapping has remained.) The specific message of the studies has been left as it was when originally published.

² In the form originally published a few technical terms which may cause difficulties to non-economist readers have been used in the studies. Where these first occur, their meanings have been explained in the notes. As a rule, definitions are not presented, since that would only lead to the use of further technical terms. In preference a paraphrase or illustration to elucidate the meaning of the term has been provided. These explanatory notes inserted by the editors have been marked at the end by an asterisk (*).

The Reproduction of Shortage*

The word *shortage* in the title refers to a well-known group of phenomena that we all encounter as *consumers*. Although in past years the supply of consumer goods has much improved, "deficit goods" still keep disturbing smooth supply. Tens of thousands are waiting to get a telephone station or to buy a car. The gravest shortage phenomenon in consumption is a housing shortage which has grown into a pressing social problem.

We keep encountering shortage phenomena not only as consumers but also as *producers*. Hindrances are not rare in the supply of materials, semi-finished products and parts. Shortage of construction and installation capacity is conspicuous in investment processes. In addition to all this, labour shortage increasingly retards the expansion of production.

Many economists and managers think that there are separate phenomena involved. Although symptoms are similar, the causation is different in each case. One kind of shortage results from the planner's fault, another one from the negligence of the factory supplying the product or the trading company that sells them, and a third one may be the consequence of the price having been fixed too low, etc.

In my opinion all the above-mentioned symptoms spring from the same root; in the final analysis they can be traced back to common main causes. We are faced with various concrete manifestations of the same *general* phenomenon. This study places in the forefront of

* First publication in English: "Resource-constrained versus Demand-constrained Systems", *Econometrica*, Vol. 47 (1979), pp. 801-819. Presidential address, presented at the North American and at the European meeting of The Econometric Society, in Chicago, August 29, 1978, and Geneva, September 6, 1978.

investigation what is common to these various phenomena and the explanations for them.

The "reproduction" of the title refers to the fact that we are not faced with temporary, provisional, occasional events but with a complex of phenomena that constantly reproduces itself under specific circumstances. It is not simply a case of "shortage breeding shortage" although such self-movement and self-generation can also feature. Shortage is continually reborn out of social conditions and certain characteristics of the economic mechanism about which we shall speak in a moment.

The analysis of shortage is a widely diverging subject. Either as a cause or as a consequence, it is interrelated with every important process of economic life. For a comprehensive analysis we ought to go through almost all chapters of economics. This short study does not aim at completeness or at a summary of a longer, more detailed train of thought. It must rest content with confining itself to a fraction of this very large sphere of problems and demonstrating certain important relationships.

Shortage can simultaneously be considered as *good* and *bad*. It is favourable that there is no unutilized capital which is unwanted by any firm for a productive use. There is full employment. (We shall later return to this.) At the same time, achievements are necessarily accompanied by troubles. Shortages cause loss and inconvenience to consumers. They often have to wait for supply, to queue up, and frequently are forced to be content with goods different from their original wish. Sometimes they cannot cover their particular demand at all. Shortage causes disturbances in production. A seller's market develops in which there is not enough incentive for improvement of quality of products and for innovation. All this is mentioned only as a preliminary: my study does not aim either at a normative evaluation, or at elaboration of suggestions. Its exclusive aim is *description of the phenomenon and explanation of its causes*.

The examination of shortage present in the socialist economy has numerous precedents in the history of economic thought. Limited space makes it impossible for me to describe them here in detail and to compare my viewpoint with that of others.

I shall carry on the analysis on a rather abstract plane; there will be no detailed representation of economic reality. Basically I treat

the "classical" form of a socialist economy, which preceded the economic management reforms of the 1960s and 1970s. I shall not discuss in detail to what extent the momentary state of the Hungarian economic mechanism is identical with, and different from, the "classical" form. A further simplifying assumption I shall make is to disregard foreign trade. I begin my study with the microeconomic approach, and turn to the macroeconomic approach in the second part.

Microanalysis

THE THREE CONSTRAINTS OF INCREASING PRODUCTION

We shall centre attention on the *producer firm*, dealing exclusively with the short-term behaviour of the firm. It is presumed that the firm strives for increasing production, and we shall not question its motivation, i.e. whether its impetus comes from the command of superior authorities, from its own voluntary decision (with a view to increased profit), or from bonuses promised to the managers, or from the urgings of customers, etc.

The question is the following: what are the *constraints* limiting efforts at increasing production? For illustration we can visualize a mathematical programming model of the firm, in which production variables are constrained by inequalities. Many thousands of constraints exist for every firm at any given moment, and, if we keep in mind the totality of firms, i.e. the whole of a national economy, many millions of upper constraints delimit production. Constraints are divided into three large groups:

1. *Resource constraints*: The use of real inputs¹ by production activities cannot exceed the volume of available resources. These are constraints of a *physical* or technical nature: the stock of labour of different qualifications available momentarily for production, the quantity of materials, semi-finished products and parts in stock, the capacity of machines and equipment ready for operation in factories, the usable space in factory premises, and so on.

2. *Demand constraints*: Sale of the product cannot exceed the buyer's demand at given prices.

3. *Budget constraints*: Financial expenses of the firm cannot exceed the amount of its initial money stock and of its proceeds from sales. (Credit will be treated later.)

Which of the three constraints is *effective* is a defining characteristic of the social system. To clarify what is meant by "effective constraint" I should like to refer again to the mathematical theory of inequality system, for instance to linear programming,² the use of which is best understood among economists. In the solution of a programming problem, equality holds for some of the constraints which are given originally in the form of inequalities. Production makes use of some resource to a full extent; the sale perhaps extends to the limit of demand; the expenses exhaust the funds available. The constraints for which equality holds are *effective* because they actually delimit the choice. Production would have been greater had the *effective* limits not been reached. However inequality holds for other constraints ("they are not exhausted") in the solution of the programming problem. These are not effective from the point of view of a momentary solution. It is as if they were not there: they are redundant, exerting no influence on the choice.

It is always the comparatively narrower constraints that are effective, for these conflict with the endeavour to raise production. Relatively looser constraints are not effective.

DEMAND-CONSTRAINED AND RESOURCE-CONSTRAINED SYSTEMS

Two "pure" types of systems are discerned from the point of view of effectiveness of constraints. One is the *demand-constrained system*. In it the effective constraint on production increase is the buyer's demand. Demand constraints are narrower than physical resource constraints. The available quantity of resources would allow a further increase of production. Yet producer firms do not avail themselves of this possibility, since they do not see the excess as saleable.

Capitalism is, in its "classical" form, a demand-constrained system. This is the economy Marx treats in Das Kapital when he writes about

the contradiction between the tendency of unlimited expansion of production and the limited purchasing potential of the market.³

Keynes's attention was centred on this problem.⁴ He analysed the ways in which effective demand can be increased. Governmental and private investments, together with the indirect effects these have on employment and consumers' demand, were among the possibilities he considered.

Modern capitalism—mainly owing to the effect of active state interventions often undertaken in the name of Keynes—can no longer be qualified a “pure” demand-constrained system.

The other “pure” type of system is the *resource-constrained system*. Here the effective constraints to an increase in production are the available physical resources. *A socialist economy is, in its “classical” form, a resource-constrained economy.*⁵

In order to avoid misunderstandings, it should be noted that if an economy is qualified as a resource-constrained system, this does not mean that in such an economy all resources are utilized at 100 per cent at every moment. In production, a more or less strict *complementarity* asserts itself in the short run. Technology is given; various inputs must be combined in fixed proportions. That is, if one of the resources proves to be a bottleneck momentarily, other resources remain partly or fully unutilized at the same time. A number of workers will be idle at the workshop if there is no material to process, or a part is missing for the installation, or there is a power cut; or, on the reverse side, there is material but it is not processed because the worker in charge of the task has not come to work. There is shortage of the resource presenting the bottleneck, and slack of the complementary resources. *Therefore, shortage and slack are not mutually exclusive phenomena, considering the whole of production and a long period, but are necessarily concomitant.*

ON MEASUREMENT

An important conclusion is drawn from the simultaneous presence of shortage and slack. The question of whether any economy is to be qualified as demand-constrained or resource-constrained, cannot be answered by observing its slacks, or its unutilized resources only.