

János Kornai's Comparative Theory and Defense of Capitalism

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Abstract: János Kornai's book on capitalism, *Dynamism, Rivalry, and the Surplus Economy*, is summarized and discussed. While Kornai stresses innovation as a great virtue of capitalism, he also characterizes the system as a surplus economy, where excess capacity, surplus stocks and unemployment are normal phenomena. The situation is somewhat symmetrical to the shortage economy typical of socialism. The centrist stance of the author, compared to interventionist and neoliberal views, is discussed. The polar opposition of capitalism and socialism is also questioned.

Keywords: capitalism, system paradigm, socialism, surplus economy, innovation, unemployment, monetary economy, state and economy

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1. Introduction

Comparative analysis of great systems has been a central theme of János Kornai's work. He referred to this subject as the "system paradigm" (Kornai, 2000). A majority of his writings have been dedicated to the economic system that tried to challenge capitalism during the 20th century, and eventually failed, culminating in a masterwork, *The Socialist System. The Political Economy of Communism* (1992). In the last 25 years, he has been one of the most active analysts of the transformation of socialist economies into capitalist economies. His last book deals with capitalism. While the author presents it cautiously as a limited work on "the *lasting* features of the capitalist system" (p. XIII), it is a significant event, that some of his followers had for some time expected.

I wrote in 2000 about *The Socialist System*: "The contribution of Kornai's (1992) work is mainly developed at the general level of comparison of capitalism and socialism, using stylised representations of both historical systems. A remarkable achievement of this book is the combination of theoretical and historical analysis of the socialist system, at the abstraction level of the "family" of national systems. The Marxian and Schumpeterian inspirations are manifest here. Who will write a twin book, with a similar Kornaian approach, *The capitalist System?*" (Chavance, 2000, p. 263). Today, the author has himself undertaken to answer this question, with *Dynamism, Rivalry, and the Surplus Economy. Two Essays on the Nature of Capitalism* (2013a). It is consequently with great interest that any follower and admirer of Kornai's work will read it.

Kornai now develops the contrast between socialism and capitalism he had put forward in earlier

works, as an opposition between a shortage economy and a *surplus economy*. The former experiences excess demand, the latter excess supply. His positive analysis of surplus as a system-specific characteristic of capitalism, is also normatively presented in opposition to economists who see related phenomena as waste, while he regards surplus as “one of capitalism great virtues, albeit one with several detrimental side effects” (p. 53).

2. Two essays

The first essay, “Innovation”, makes a strong argument in favor of capitalism, as opposed to socialism, by stressing this great, but for Kornai neglected, beneficial attribute of the system. Listing 111 revolutionary innovations that appeared since 1917 principally in the field of consumer goods and services, he observes that all but one originated in capitalist economies. The main cause of such dynamics is schumpeterian entrepreneurship; it is accompanied by creative destruction. While it has its dangers, resulting technical development is rightly called *progress*, as may be observed in the daily life and work of the population; it is a component of *modernization*. An important illustration is given by the experience of postsocialist countries, that underwent a visible acceleration of technical progress in their process of system transformation; however, even though the people’s life has been transformed and they benefit from the advantages of technical progress, they often do not understand that it is a consequence of capitalism, that has a poor reputation in this region. The essay is a schumpeterian plea for capitalism, with a general perspective, but formulated by Kornai in a context where he feels that capitalism is not appreciated as it should.

The second, more substantial essay is “Shortage economy – surplus economy”. Considering markets for goods and services in capitalism, Kornai observes that the forces producing recurrent surplus are related to supply (monopolistic competition, uncertainty of demand, innovation and creative destruction, economies of scale), to demand (resistance of employers to employee’s claim for higher pay), and to price stickiness downward. Labor surplus, or unemployment, has diverse aspects and causes: “Keynesian” (cyclical), structural (creative destruction), frictional unemployment (mismatch), efficiency wage. A number of different themes are thus invoked to corroborate that unemployment is an essential component of the surplus economy.

Summarizing the causal chain between nine “blocks” of factors of the surplus economy, Kornai lists: 1. Private property and market coordination, 2. Entrepreneurship, 3. Hard budget constraint, 4. Supply: expansion drive, 5. Curbing the increase of demand, 6. Stickiness of price adjustment, 7. Stickiness of wage adjustment, – ending in manifestations of the surplus economy proper: 8. Excess capacity, surplus stocks, 9. Surplus labor.

Beyond positive analysis, Kornai gives his assessment of the surplus economy. Its principal economic advantage is dynamism resulting from innovation, both a cause and an effect of competition, and the rapid advance that it entails; its beneficiaries are “all those whose lives are made more comfortable,

stimulating and productive” and who “experience price reductions” (p. 126). While the consumer may be manipulated, and is therefore not an absolute sovereign, he is “like a ‘strong’ president of the republic, who influences decisions and can veto them.” (p. 128) “The surplus is the ‘lubricant’ that softens or silences the creaks in the machinery of adaptation” of producers to consumer wants (p. 127).

3. Contradictions: Good and bad characteristics

Ultimately, Kornai gives an unexpected hierarchy of reasons for his stand in favor of capitalism and the surplus economy, as opposed to socialism. The first is that capitalism is in his view a necessary (although not sufficient) condition of political *democracy*. Second comes the main rationale developed in the book: the system is associated with the continual process of innovation and rapid technical change, ultimately raising the standard of living. All other virtues of the surplus economy “rate only third in my eyes” (p. 135).

The author emphasizes that “capitalism is an organism burdened with contradictions, with strong good and strong bad characteristics” (p. 136), its immanent propensities are part of its “nature”. Believing that its problems could be entirely solved would be naive, but “much can be done to alleviate the detrimental effect of the surplus economy”, as for example: procurement and inventory policies, state regulation in view of fair competition, fight against corruption, even medium and long-term indicative planning (p.137). It is also “possible and imperative to create a macro policy and system of institutions that reduces unemployment and makes it more bearable”, but it is wrong to advertise “full employment” (p. 105).

“The capitalist system and the socialist system are interpreted in this essay as two theoretical models, or ‘ideal types’, to use Max Weber’s expression.” (p. 53). The idealtypical method is based on concepts that deliberately amplify some aspects of reality. We observe that aspects of the system emphasized in the book are dynamism, innovation, unemployment and surplus; other characteristics understated or left aside are instability, crises and inequalities.

The most original aspect of the volume is the concept of surplus economy, the valorization of surplus as a positive quality of the capitalist economy, and the stress on interrelations between various factors and consequences of surplus. It is to be hoped that they will stimulate discussion, and possible developments – of which a number are directly suggested in the book. In this paper I shall briefly discuss some themes related to the system paradigm and to the normative assessment of capitalism.

4. Types of innovation

The reader is surprised to see that the relation between innovation and surplus is not explored in detail. We read that “Many projects are needed for the few great successes, and, at the same time, we may get too many of them” (p.34). Considering business cycles in a schumpeterian perspective might give a

possible direction for a connection between the two main themes of the book, with the benefit of stressing the question of *crisis* as a characteristic of capitalism – which is rather left in the background. This is one of the questions opened by *Dynamism, Rivalry and the Surplus Economy*.

Kornai focuses on product innovation. Going beyond Schumpeter, we could stress the role of institutional and organizational innovations, that have historically proved so important in the long-term viability and resilience of the capitalist system, as opposed to the systemic and structural obstacles they met in socialism (Chavance, 1999). Schumpeter missed this adaptive capacity of capitalism through institutional and organizational evolutionary change, when he predicted that it was heading to its end. Such argument could be added to Kornai's defense of the system; he does not seem to share today the pessimistic anticipations that Schumpeter made in the 1940s.

5. Systemic symmetry and the level of abstraction

Kornai discusses capitalism and “its opposite” (p. 3), socialism. He presents the characteristics of the two systems in sharp contradistinction, insisting on a kind of symmetry between their characteristics; this is specially the case for the “demand-supply regime” where shortage is opposed to surplus, and for innovation, where socialist sluggishness or imitative tendencies are measured against capitalist dynamism and its creative destruction.

The contrasting approach helps to focus on great oppositions and summarize system-specific characteristics. The level of abstraction chosen in the book, common characteristics of the “families of systems”, or capitalism and socialism *in general*, is clearly justified by the author. But it sets some limits to conceptualization and comparison.

At a higher level of abstraction, and considering a long term historical perspective, we are also faced with the common features of the two great economic systems, as their monetary and wage-labor characteristics. In this respect, they could be seen as two species of a same genus, with their differences but also their process of transformation from the one to the other seen in that perspective (Chavance, 1999). While the author stresses the development of innovation and the emergence of unemployment as manifest tendencies that went along the transformation from socialism to capitalism, at a superior level of generality we could consider the alterations observed in the spheres of money, and wage labor nexus – as these institutional dimensions were not created during system change, but *changed forms*. Some characteristics found by Kornai in both systems – as the soft budget constraint – might consequently appear in a new light.

Considering now a lower level of abstraction, we find the important question – left aside explicitly by the author – of the diversity of national and historical capitalist systems, or varieties within the system family. It would be interesting to examine the vast literature on diversity of capitalism in the light of the theory of the surplus economy and ponder which parts of the latter are vindicated and which parts are qualified or modified by it. A historical period that is absent from Kornai's perspective is the “golden

age” – a quarter of a century – of post-war growth in capitalist economies, quasi full employment, limited income inequalities, and strong regulation of national systems as well as rather stable rules of international organization of the world economy. Some “genetic tendencies” Kornai sees in the system were strongly mitigated during this period, while innovation, dynamism, and increase in the standard of living were nevertheless manifest. Galbraith had seen a kind of civilizing process of capitalism at work at that time, stimulated by the rivalry with socialism; an implication of Kornai’s approach would rather be that this was a kind of historical exception, but he does not mention it.¹

6. Affinity and coherence

An important theme in previous works of Kornai consisted in stressing the affinity between different characteristics of a given system, and its general coherence: this was true for both classical socialism and capitalism. This approach is akin to the notion of institutional complementarities later developed by some institutional economists (Aoki, 2001, Amable, 2003) at the level of national forms of capitalism. In this book, he gives examples of historic tendencies that may, as a matter of fact, question affinity and coherence. Under the rubric of “historic changes and long-term tendencies”, he notes important “alterations” in the capitalist system. The first is the growth of the welfare state. When it is associated with free or almost-free public services, shortage will appear within a surplus economy; it is as if “islands” of shortage economy developed in a sea of surplus: in the health system, or in higher education (p. 151-154). The second long-term tendency is softening of the budget constraint: while the hard budget constraint has remained dominant since the beginning of capitalism (p. 155), “financial rigor seems to have slackened and bailouts proliferated” (p.154). In this case, coherence and affinity are tendentially reduced. In *The socialist system*, it was shown that economic reforms had lowered the coherence and affinity within socialist systems, and destabilized them, possibly leading to crisis; such possibility is however not raised here about capitalism. The reader may feel that Kornai sees great systems as having a strong coherence in their original or classical form, and evolving toward more complicated, hybrid and conceivably weakened forms. But in this book the image of an original or classical capitalism is not clearly defined, as was classical socialism, which had been precisely abstracted from the variety of historical forms within the “family” of socialist systems. We are indirectly reminded that most theories of capitalism had been based on two specific historical national cases, Great Britain in the 19th century, USA in the 20th century. A bias consequently often remains for a genuine “family of systems” approach.

Schumpeter (1942) had asserted that precapitalist forms had played a significant role in capitalism (or the equivalent of a “classical form” in his eyes), so that their erosion was one factor of its declining viability. More generally Geoff Hodgson argues for the “impurity principle” which means that “every socioeconomic system must rely on at least one partially integrated and structurally dissimilar subsystem to function”; “there must always be a plurality of provisioning institutions, so that the social formation as

a whole has requisite variety to promote and cope with change” (Hodgson, 2001, p. 334). Or in a review of a previous book of Kornai, Ivan Szelenyi (2009) had observed, about “mixed economies and the elective affinity between forms of economic integration and property rights”, that “it is far from obvious that the purer the economic systems are, the better they work.” At any rate, *Dynamism...* calls for revisiting notions of coherence, affinity or institutional complementarities in great systems, particularly from an evolutionary perspective, that Kornai wishes to follow (p. 110).

7. Dichotomy of real and monetary economy

Kornai acknowledges that it is “almost impossible” to discuss the markets for goods, services, and labor “and ignore the financial sector” (money, credit, monetary policy), but adds that (in view of limits of energy and time) he has chosen to do it in a limited essay (pp. 55-56). Most of the book is thus centered on the real sphere, the “supply-demand regime”, it abstracts from money and finance. It is a somewhat dichotomous approach, even though the author underlines its limits.

However the monetary character of the capitalist economy – and the consecutive invalidity of “Say’s law” (as both Marx and Keynes had noted) – might be seen as an essential factor of surplus, possibly at a more fundamental level than some real factors stressed by Kornai. Keynes’ notion of an “active money” or of a “monetary production economy”², was associated to phenomena that may be related to forms of surplus, e.g. the possible failure of the anticipated exchange according to Marx, or the boom period in the cycle for Schumpeter, or the probability of unemployment for Keynes himself.

8. Positive analysis and normative stance

Kornai’s discussion of his own theory, and his call for a positive synthesis of different schools, invites to consider his original position in the field of economics, as specified in this book.³ He writes that his references “spread across orthodoxy and heterodoxy, mainstream and out of mainstream”: “I handled this multiplicity of intellectual affinities ironically in my earlier writings, describing myself as eclectic.” (p. 137).

He is keen on distinguishing the discussion about a positive theory of capitalism, and normative analysis. “Schumpeter was one of the main inspirations of my work, and he was inclined toward conservatism in his political statements. I learned a lot about interpreting the operation of the market from Mises, Hayek, and the later followers of the Austrian school, their political statements belong to the right wing of the political spectrum. Keynes was a liberal politician. Nicholas Kaldor, with whose ideas I feel a strong intellectual affinity, was politically very active on the left wing of the British Labour Party. Most representatives of New Keynesian economics sympathized with the liberal Democrats of the US political spectrum. In the analysis of excess capacity, I have many points of contact with the present-day post-keynesian school, for instance with the writings of James Crotty (2001 and 2002); he and other

prominent members of the school are expressly left wing. Finally, at the end point of the spectrum this essay takes Marx's position on one or two cardinal questions." (p. 140-141) If we understand correctly, this implies that positive analysis may refer to different schools or thinkers, without having to be necessarily classified in a doctrinal or political box; this has actually been a constant of Kornai's position. The author goes further: he lists for example as "elements of positive synthesis" for the comparison of shortage and surplus economy authors or schools of different perspectives, as Marx, Schumpeter, Kaldor, Arthur, the Austrian school, the theory of imperfect competition, Keynes, Kalecki, the post-keynesian school, Stiglitz and Shapiro, evolutionary economics, Akerlof and Shiller, behavioral economics, new keynesian economists, Phelps... He maintains that "positive description and explanation of a well-defined scientific field is not only desirable, but also feasible; a broad synthesis of the theories, scientific explanations, and research methods can be achieved." (p. 141)

A question emerges here. As a highly creative and rigorous thinker, Kornai can succeed in building a theory involving a controlled and reasonable eclecticism, in the sense of finding inspiration in different, sometimes opposed schools of thought. But the notion of a broad synthesis that would bring economics *as a social science*, or a given field of it, to a shared theory seems problematic – even when limiting the project to positive analysis.

By providing more detailed remarks on what may be done with good and bad characteristics of capitalism, the book presents a clearer doctrinal position of the author. This position could be summarized as intermediate between the old neoclassical synthesis where state regulation and action are necessary and possible to cope with the bad features of the economic system, and a neoliberal stance in which its dominant good sides should not be impaired by excess intervention of the state. A traditional dichotomic view of the state and the capitalist economy, where they appear as two "alien organisms", with a difficult coexistence (Kornai, 2012), is implicit. Kornai is here closer to Schumpeter or even Hayek, even though he maintains a reference to the neoclassical-keynesian stance: state policies or regulation are necessary, – but they should remain in stricter limits than is often the case.⁴ Such position is often presented by the author under a kind of centrist formula: after the recent recession, "policymakers should avoid both types of mistakes; going too far in deregulation, or introducing too much (and/or ill-targeted) regulation" (p. 35); the public mood is upset because of skyrocketing earnings of many business people, however the "huge reward" expected by would-be innovators is a condition for risk-taking, so the author wants to "draw the attention to the two (mutually contradictory) aspects of very high business income" (35)...

The general idea that the state and the capitalist economy are alien organisms with complicated coexistence is anchored in the dominant tradition of economics, but it is debatable, both from a historical and an evolutionary point of view, as argued for instance by Polanyi (1944) and Commons (1924, 1934). And the more contemporary arguments mentioned above seem questionable. The alleged present threat of overregulation – of banks and financial markets – is not convincing, the shift consecutive to the current great crisis having remained minimal in light of the threats of financialized capitalism; this idea

also forgets about the previous intensive period of deregulation, that was condensed in the 1980s and 1990s, and its direct role in the current crisis. As for the supposed ambivalence of very high business incomes, it implies that the latter are linked to innovation, while they are principally the result of the process of financialization of contemporary capitalism. In the high growth period of capitalism, innovators had not been discouraged by much more restricted scales of income inequalities, and much higher levels of high incomes taxation (Piketty, 2014).

9. A timely defense of capitalism?

Kornai made a case in 1992, after the collapse of communist regimes of Europe and of the Soviet Union, for the publication of *The Socialist System*, by the historical and theoretical significance of its subject. And rightly so. More surprisingly, this book presents in 2013 a nuanced but ardent defense of capitalism at a time when the attraction of its competitor has almost totally vanished from historical prospects, and when many capitalist countries are faced with a severe crisis, that it has become frequent to compare with the strains of the 1930s. If the disappointment with capitalism or the market economy is well documented in a part of the postsocialist world, as Kornai shows in the book, – the most enthusiastic country entering the capitalist family is the formerly socialist, and most populous country in the world: China.

It is true, and understandable, that some traditional criticisms of capitalism have been revived by the present historical situation. Such criticisms may be instrumentalized by worrying political forces, particularly in Europe, sometimes evoking the situation in the 1930s. But the transformations of the system itself in the late 20th and early 21st century have played their role in reviving anticapitalist feelings. The balance of virtues and faults has changed significantly in the developed part of the world; on the other hand the notion of a “feasible” alternative of socialism has waned. Going down again in abstraction, it seems advisable to amplify the debate on diversity, varieties, – existing or possible *forms* of the capitalist system.

Kornai generally has a much more sober approach, and more qualified arguments than Hayek in his defense of capitalism. However, his constant irritation at critics of capitalism indirectly reminds of the remark Schumpeter about Hayek and his *Road to Serfdom*: “if he had gone into historical conditions from which the ideas arose which he dislikes so much, he could not have helped discovering that they are the products of the social system which he does like” (Schumpeter, 1946, p. 270).

Dynamism, Rivalry and the Surplus Economy actually gives an inspiring contribution to a research program somewhat left behind by the profession of economists. It may not lead to a grand synthesis, but it will encourage a renewed and welcome plurality in the approach of the nature of the capitalist system. It will also stimulate the debate on its (comparative and absolute) virtues and faults.

Notes

- ¹ Incidentally, the *coevolution* of capitalism and socialism during 70 years, was an important factor of their internal dynamics, that is not discussed by Kornai. It does not question the contrastive model of systems, but may qualify it in a historical perspective.
- ² Keynes opposed this notion to the vision of a “real exchange economy” that he found in the “classics” – the latter image has some affinity to the demand-supply regime where abstraction is made of money.
- ³ On this question, see his autobiography, *At the force of thought* (Kornai, 2006), and his 2013 interview (Kornai, 2013b).
- ⁴ In the first book published on the eve postsocialist transformation, *The Road to a Free Economy*, 1990 (a wink at Hayek's *The Road to Serfdom*), Kornai had first said that after decades of maximum state it was time to accelerate the move to a minimal state, adding that future generations might later consider a middle term. But faced to the « transformational recession », he admitted later that believing that the spontaneous forces of the market and of private initiative would bring back growth had been one sided, and that such attitude had been “too doctrinaire” (1993).

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