

INSTITUTIONAL ECONOMICS





NEW

SZÉCHENYI PLAN

INSTITUTIONAL ECONOMICS

Sponsored by a Grant TÁMOP-4.1.2-08/2/A/KMR-2009-0041

Course Material Developed by Department of Economics,

Faculty of Social Sciences, Eötvös Loránd University Budapest (ELTE)

Department of Economics, Eötvös Loránd University Budapest

Institute of Economics, Hungarian Academy of Sciences

Balassi Kiadó, Budapest



The project is supported
by the European Union.

National Development Agency
www.ujsechenyiterv.gov.hu
06 40 638 638



HUNGARY'S RENEWAL



The projects have been supported
by the European Union.

ELTE Faculty of Social Sciences, Department of Economics

INSTITUTIONAL ECONOMICS

Author: János Mátyás Kovács

Supervised by János Mátyás Kovács

June 2011

INSTITUTIONAL ECONOMICS

Week 13

Reception of institutional economics in Eastern Europe III

Acceptance and rejection of New Institutional Economics
after 1989; the case of Hungary

János Mátyás Kovács

Contents

- Borderline-case economics?
- Theory of shortage
- Pioneers and followers
- The case of Hungary

Borderline-case economics?

- By the early 1980s, the radical-minded reform economists are ready to switch from speculative to “normal” institutionalism.
 - Knowledge of institutional behavior grows rapidly (case studies and comprehensive research on investment cycles, public finance, informal economy, foreign trade, labor market, etc).
 - Neoclassical theory (“mathematical economics”) trickles down from optimal planning, and new university courses are launched in econometrics (and in macro- and microeconomics in some countries).
- The radicals approach a sort of “borderline-case economics”: they study *in vivo* the *in vitro* problems of Western market economies (shortages, business cycles, informality, government failures, etc).
- However, a common language on property rights, principal-agent relationships, moral hazard, rent seeking, etc, and – more importantly – on the concept of rationality in general is lacking.

Borderline-case economics? (cont.)

- Remaining obstacles
- From the perspective of the theory of science:
 - The older generations are traditionally interested in macro- rather than micro-problems.
 - The case study authors and the scholars working on current economic history prefer “thick description” to model building; they reinvent NIE concepts (property rights, government failure, etc) rather than taking them over.
 - They regard the Yugoslav economic institutions as too collectivist and highly specific.
 - The younger experts are hungry for a rigorous and consistent (pure) theory instead of borrowing another (suspicious) mixture such as the NIE as they perceive it.

Borderline-case economics? (cont.)

- Even in the eyes of radical reformers, the gap between market socialism and neoliberalism is too large; they rather opt for some kind of social liberalism (regulated versus free markets); devoted neoliberal thinkers are rare (exceptions: Poland, Winiecki, Lewandowski; Czechoslovakia, Klaus' group; more complicated cases: Hungary, Liska with his “entrepreneurial socialism”; Soviet Union, Shmelev).
- From the perspective of sociology of science
 - The reformer as political entrepreneur: certain concepts of NIE (e.g., property rights) are iconoclastic; they may jeopardize cooperation with the ruling elite.

Borderline-case economics? (cont.)

- It is difficult to harmonize the social engineering roles of the reform economists with NIE's evolutionary philosophy (this remains problematic after 1989: from reformers to “transformers”) as well as reform from above with spontaneous change from below.
- The communist system collapses “too early”: a specific – Eastern European – NIE does not have time to unfold freely

Theory of shortage

- Equally important is the fact that it seems that Eastern European economists are not exposed to Western imports: good-quality domestic goods are available as well:
- First of all: economics of shortage (Kornai); reservations concerning reform economics do not seem to apply to it because the theory
 - is formulated in both mathematical and verbal terms
 - relies on abstract and empirical research
 - strives to quantify its results
 - description and analysis offset normative conclusions
 - provides a comprehensive and systematic explanation of institutional behavior (a new political economy of real socialism? *Das Sozial?*)
 - experiments with new concepts (paternalism, rush, friction, forced substitution, soft budget constraint, etc)
 - captures the essence of the system: shortage

Theory of shortage (cont.)

- conducts a dialogue with modern economics: Anti-equilibrium and the theory of soft budget constraint; reflecting on Keynes: cyclical lack of demand versus chronic excess demand
- is not speculative: clear assumptions, exact definitions, testing
- is suggested by an author who is not a reform-maker cooperating with the party-state (though exercising self-censorship)
- Yet, the "Economics of Shortage" :
 - disregards a great many crucial institutional factors: public ownership, one-party system, militarization, shadow economy, dependence on the Soviet Union, etc
 - puts a soft (speculative?) concept, paternalism in the center of analysis
 - does not apply the first results of NIE
 - displays neutrality in the dilemma of free markets versus state intervention

Theory of shortage (cont.)

- Critique of the shortage theory (Portes, Gomulka, Soós, Klaus, Shleifer/Vishny)
- It has not become a Grand Political Economy seen from the perspective of NIE, although the research program could be continued (e.g., the "Socialist System" by Kornai).
- The basic impression in the region: "the main questions have been answered"
- The West does not consider the theory of shortage mature for a Nobel Prize (orientalism?, becoming obsolete?, changing language of economics?).
- The return to universal economics ("prodigal son") takes place *not* in the field of the theory of communism.

Pioneers and followers

- Yugoslavia: the theory of self-management, standard microeconomics and the property rights school come together (Pejovich) and become a legitimate research program back in the 1970s (Dubravcic, Gligorov, Prasnikar, Suvakovic).
- In other countries, neoclassical analysis of the communist economy is sporadic (Czechoslovakia: Hlavacek, Klaus, Mlcoch, Toms, Triska, Magyarország: Galasi-Kertesi).
- Too little too late? In principle, NIE could have become the main research program of the younger generations who were frustrated with reform economics, and well-equipped with the tools of modern economic analysis.

Pioneers and followers (cont.)

- Aborted initiatives, unexploited possibilities (Grosfeld); research on post-communist transformation is more attractive and can be made with the help of OIE as well.
- Borderline-case economics: it has not been written yet; meanwhile in Eastern Europe communism dropped out even from economic history-writing.
- Kornai: *“I did not use the term ‘institution’ in every second paragraph as it recently has become fashionable to do, but I think I understood what a system means, and what the difference is between socialism and capitalism ... (1999)*

Pioneers and followers (cont.)

- How did NIE develop in the individual countries of Eastern Europe after 1989 when one could not really explain scientific evolution referring to isolation and censorship any longer
 - OIE withdrawing but no NIE breakthrough in sight
 - Neoclassical theory had a sweeping victory; it has not produced its own local dissidents yet who could find home in NIE.
 - Anything goes: even hybridization is a too strong assumption seeing the emerging blend of old and new paradigms/discourses in the region.
 - Bad joke: institutional economics has hardly been institutionalized yet.
 - Slow, eclectic, simulated takeover; small islands of NIE scattered all over the region; popularization and application rather than original discoveries.

Pioneers and followers (cont.)

- This contradicts even the pessimistic expectations; besides the “instinctive institutionalism“ of Eastern European economists, there were quite a few other reasons for predicting smooth and rapid reception.
 - Certain NIE subdisciplines can be understood with a low degree of mathematical knowledge.
 - One does not have to be a devoted neoliberal to subscribe to most NIE theories.
 - NIE may enchant the newcomer with its novelty and heterodox status.
 - It was well marketed throughout the region in the first half of the 1990s (foundations, conferences, book series, etc).
 - The first wave of reception coincided with many of the NIE Nobel Prizes
 - Post-communist transformation and the accession to the EU offered plenty of institutional research themes.
- It is first Alchian, Demsetz, Olson, Leibenstein, Simon who were among the most cited in Eastern Europe, then came Buchanan, Coase, North and Fogel; following a longer break, there was a new boom of interest due to the Ostrom/Williamson Nobel Prizes.

Pioneers and followers (cont.)

- At the same time,
 - The basic works are often translated into the local languages at random.
 - The new mainstream economists in the region show suspicion toward the local NIE followers (is this the way in which these want to skip mastering the neoclassical instruments?).
 - There emerge strange mixes: (Romania: combining Hayek with Orthodox religion; Hungary: former party leader teaching public choice).
- Maybe, NIE is in a phase of silent accumulation, and there is no reason for impatience.
- NIE types in Eastern Europe:
 - Ex-reformers seeking refuge
 - Intransigent verbalists
 - ORDO rearguard
 - Pragmatic institutionalists
 - NIE neophytes
 - Symphatizers in other social sciences, etc
- Top publications only by Russian scholars (Guriev, Sonin, Zhuravskaia)

The case of Hungary

- Unique solutions? Just a few specific traits in the reception of NIE:
 - Vast inertia of speculative institutionalism
 - ORDO is still taught at Catholic/German language universities, and ex-reformers also cherish its memory; the notion of social market economy appears on the extreme right, too.
 - The Austrian extension of ORDO is, however, not popular: neoliberal rhetoric à la Klaus or Balcerowicz is rare (the Polányi tradition is strong).
 - Kornai-effect: cautious/gradual reception mixed with own discoveries, critique of the "vulgar-Coaseists", simultaneous reception of OIE and NIE.
 - A new wave of reception at the turn of the millennium (Csontos' role), new translation projects, university courses.

Readings

Mandatory

Galasi és Kertesi: Korrupció és tulajdon, 1990

Grosfeld: Reform Economics and Western Economic Theory. Unexploited Opportunities, 1992

Kornai: Economics of Shortage, 1980 (chapters)

Wagener (ed): Economic Thought in Communist and Post-Communist Europe, 1998 (chapters)

Additional

Domar: The Soviet Collective Farm, 1966

Kornai: A gondolat erejével , 2005 (chapters)

Kovács: Beyond the Basic Instinct? On the Reception of New Institutional Economics in Eastern Europe, 2011

Vanek: The General Theory of Labor-Managed Market Economies, 1970 (chapters)

Ward: The Firm in Illyria: Market Syndicalism, 1958

Annex

- Biographical sketches
 - Balcerowicz
 - Klaus
- Final questions
 - Predecessors/successors of the school
 - Friends and foes
 - Discoveries
 - Changes in the research program

ELTE Faculty of Social Sciences, Department of Economics

Thank You for using this teaching material.

We welcome any questions, critical notes or comments we can use to improve it.

Comments are to be sent to our email address listed at our homepage,

eltecon.hu