

# **We're All Austrians Now: János Kornai and the Austrian School of Economics\***

Peter T. Leeson<sup>†</sup>  
George Mason University

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<sup>†</sup> Email: pleeson@gmu.edu; Address: Department of Economics, George Mason University, MSN 3G4, Fairfax, VA 22030.

# 1 Introduction

The Austrian School of economics occupies a peculiar position in our discipline.<sup>1</sup> On the one hand, it is largely marginalized. Apart from the occasional, obligatory citation to F.A. Hayek's *Road to Serfdom* (1944) or *Constitution of Liberty* (1960), very few self-described Austrian economists are mentioned in the upper echelons of the mainstream economics literature. Hayek's teacher and former "Dean of the Austrian School," Ludwig von Mises, who laid out large tracts of the theoretical Austrian landscape that inspired the careers of a number of notable economists, such as Hayek, is almost never discussed. Even in many contemporary, mainstream discussions of the infamous "socialist calculation debate," such as the one offered by Joseph Stiglitz (1994), Mises, whose 1920 article, "Economic Calculation in the Socialist Commonwealth," initiated this debate, does not get so much as a mention.

Despite this apparent marginalization Austrian economists also have good reason to rejoice. Many Austrian *ideas* forged originally by Mises, Hayek, and others, have crept their way into the work of major mainstream economists. Although Austrians are rarely credited, to anyone familiar with their work, the basic concepts at hand are unmistakably "Austrian." In this sense Austrians have been victorious. Perhaps no where is this increasing tendency more apparent than in the celebrated Hungarian economist János Kornai's new autobiography, *By Force of Thought*. Although the book's subtitle suggests that these memoirs are "irregular," in fact they are well organized and can be easily digested even by those unfamiliar with Kornai's work.

This sporadically immodest account of Kornai's life weaves together his personal story—one of adolescence in Nazi-controlled Hungary, young adulthood as a committed communist, and later adulthood as an economist growing out of his socialist youth—with Kornai's

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<sup>1</sup> For a discussion of the Austrian School from 1950 to 2000, see, Boettke and Leeson (2003).

intellectual story, recounting the emergence and substance of his major work. Kornai's life is indeed a fascinating one and, as he describes, created potent fodder for the development of his contributions to economics.

The present essay has two purposes. First, I hope to give the reader a flavor for the basic contents of Kornai's book. Second, I aim to draw attention to the important and close connections between several of Kornai's major works discussed in his autobiography, as well as their genesis, and the ideas and genesis of these ideas in the Austrian tradition associated with Ludwig von Mises and F.A. Hayek. Although Kornai briefly refers to Hayek's *Road to Serfdom* in discussing the evolution of his impressive intellectual journey, Mises, as is typical, receives no mention. More importantly, the close connection between the substance and development of several of Kornai's ideas and those of Mises and Hayek are virtually unnoted. In pointing to the Austrian precursors to Kornai's work I do not intend to detract from the important contributions Kornai has made to our understanding of the economic world. Instead, my goal is highlight how in several important respects these contributions are "Austrian" ones. Although the absence of an explicit connection to the ideas of Hayek, and even more so to those of Mises, may chafe some Austrians, a measure of self-satisfaction is also warranted when an economist of Kornai's stature, however unwittingly, grounds his highly-praised contributions to economics in the ideas of the Austrian School.

## **2 Life**

János Kornai was born János Kornhauser, January 21, 1928. The son of a prominent Hungarian business attorney, Kornai grew up with three siblings, though he says that he was clearly his mother's "favorite among" the four children (Kornai 2007, p. 5). His impressive intellect was

evident from an early age and seemed to benefit from the tremendous independence his busy parents gave him from the beginning.

Kornai's family, like many others in Hungary in 1944, suffered at the hands of Nazi control. The Nazis took his father to a "work camp," whose inmates were ultimately moved to Auschwitz where Kornai's father was killed. Kornai's personal experiences with Nazism, coupled with Soviet liberation of his family at the end of WWII, fueled his first ideological turn, which was to communism.

Chapter 2 of Kornai's book, provocatively entitled, "How I Became a Communist," describes this process in depth. Kornai identifies "five grades" of communist identification, each of which he went through on his way to becoming a full-blooded believer. The first of these is sympathizing with the Communist Party as an outsider. The second step is becoming a party member. The third is engaging actively in this membership. The fourth step is that of becoming "a true Communist"—not only thoroughly training oneself in Marxist-Leninist theory, but also subordinating one's private interests to the party. The fifth and final step is becoming "a party warrior, a professional party worker" (Kornai 2007, pp. 24-25).

In Chapter 3 Kornai describes how in his capacity as a "party warrior" he worked as an economic columnist for Hungary's daily newspaper of the Communist Party, *Szabad Nép*. In this job, which he held for nearly a decade between 1947 and 1955, Kornai faithfully reported on the economic success of various aspects of Hungary's socialist system and encouraged workers and producers to reach quotas set by economic plans, reminding them of the important and righteous mission they were a part of as comrades in the communist system.

It was in the latter years of working for *Szabad Nép* that Kornai began to notice serious fissures in the socialist edifice. But rather than abandoning the idea of a planned economy

wholesale, he initially sought for ways to improve it by introducing a greater, though still very limited, role for markets in the socialist system. According to Kornai, “Never for a moment did I think that the troubles [with socialism] were *systemic*, originating in the system itself. On the contrary, while perceiving many problems and faults in it, I was still convinced that socialism was superior to the capitalist system” (2007, p. 51).

Ultimately, it took the government’s arrest and torture of a man Kornai knew to be innocent to shake his faith in Hungary’s Communist Party. As Kornai describes in Chapter 4, appropriately-titled, “Waking Up,” only then did he begin to question the system he had until this point devoted his life to. Although Kornai went on to become known as an important critic of the economic side of socialism, it was actually the system’s “ethical failures,” rather than the economic ones, that awoke Kornai from his dogmatic slumber. As Kornai puts it, these ethical failures “undermined the moral foundation on which I had hitherto based my Communist convictions” (2007, p. 60).

From this point forward Kornai’s newly-opened mind began to be able to see, and increasingly critically scrutinize, the reality of the socialist economy. After being fired from his post at *Szabad Nép*, in 1955 Kornai started what was the beginning of his illustrious research career. Although he was never permitted to teach a “real” university course in Hungary, his growing stature as a researcher over the next 30 years gained him international recognition, culminating in an offer from Harvard in 1985. The beginnings of this recognition resulted from his dissertation thesis, *Overcentralization*, published in English in 1959, which created a commotion in the West by providing one of the first insider accounts of the socialist economy. Chapters 5-15 discuss the evolution of this research over the next three and a half decades of Kornai’s life.

Each step in the pursuit of Kornai's research agenda was in some way intimately connected to the evolution of his thinking about socialism vs. capitalism more generally, as he successively broke the vestiges of lingering belief that some form of centralized economic planning was desirable. These chapters are littered with fascinating tidbits, both personal and intellectual. I will not attempt to do them justice here. Instead I confine myself below to a consideration of only a few of the larger intellectual themes that unfolded in Kornai's life over this lengthy period leading up to the collapse of communism in the late 1980s and early 1990s.

### **3 Two-Level Planning and the Mises-Hayek Socialist Calculation**

#### **Critique**

As noted above, Kornai's earlier "critiques" of socialism were very much half-hearted in that, although they sought to bring a larger part of the socialist economy within the purview of markets or "quasi-markets," they still saw a significant and important role for state ownership and central planning of the economy. One of Kornai's most well-known contributions to this area was his 1965 *Econometrica* paper, "Two-Level Planning," which he coauthored with Tamás Lipták, who did the mathematical modeling in the paper. This work extended previous work Kornai conducted with Lipták, which used mathematical methods to tackle various aspects of efficient planning under market-socialist type arrangements.

The Kornai-Lipták two-level planning idea is very much reminiscent of the Taylor-Lange market socialist models described 30-35 years earlier in the throws of the early stages of the socialist calculation debate with Austrian economists Ludwig von Mises and F.A. Hayek. The Taylor-Lange model worked as follows: let there be a market in consumer goods and labor but leave the means of production in government's hands. The central planning office will set prices

for producer goods and on the basis of these “accounting prices” producers will be instructed to set price equal to marginal cost and to combine resources in such a way as to minimize average cost. Of course, the initial administered prices will be wrong. At these non-equilibrium prices some goods will sit unpurchased; for others there will be excess demand. The resulting shortages and surpluses will signal to planners how they need to modify prices to bring the economy into equilibrium. Through trial and error the planners will engage in a kind of Walrasian auctioneer tatonnement process that will eventually converge on or approximate general competitive equilibrium. This equilibrium will have the same efficiency properties that general competitive equilibrium has in the Walrasian world in which producers’ goods are privately owned (or rather more precisely, there are no institutions of ownership of any variety).

Kornai’s model argued similarly but with a slight twist. The structure of ownership (state for producers’ goods, private for consumers’ goods) was essentially the same as in Lange, but instead of the central planning office setting prices, which producers were to respond to parametrically, reporting quantity information back to the center, the central office would set quantities in the form of input quotas and output targets and producers “would devise optimal plans to satisfy the center’s demands . . . and then report back shadow prices for their resources and targets” (Kornai 2007: 143). In other words the Kornai-Lipták model reversed the flow of information between the central planning office and producers in the market socialist economy.

Forty years after writing this paper, in his memoirs Kornai seeks to assess the “lasting validity” of his idea. His reflections reveal that he ultimately evaluates his market socialist model using criteria introduced by Mises and Hayek in their original responses to proposals like Lange’s during the calculation debate of the 1920s, 30s, and 40s. The core of the Mises-Hayek market socialist critique had several elements, only a few of which I will touch upon here. The

first of these is the necessity for the “correct” institutions—namely private property rights—for rational resource allocation. The second of these is the necessity of information, which exists in a decentralized and fragmented form, dispersed throughout the members of society, in order to bring individuals’ economic plans into coordination with one another. The third of these is the uselessness of the fictional Walrasian equilibrium economy for economic calculation and rational resource calculation.

I will deal with one and three later. Here, I want to make the connection between the Mises-Hayek “information argument” and Kornai’s ex-post evaluation of his two-level planning model. As he puts it today, his model requires that “All information in the model is accurate, whether it is flowing upward or downward.” However, “the reality of the socialist economy is that all items of information are uncertain” (Kornai 2007: 146). This is not the only requirement the model must satisfy, but it is among the most six critical assumptions its operation rests on. And, as Kornai tells us, “it is [in fact] *impossible* for them to be fulfilled” (2007: 146).

Kornai’s assessment of the market socialist model he proposed and even his choice of language in rendering this assessment is strongly reminiscent of the Mises-Hayek position. Mises’ original argument was that economic calculation under socialism is “impossible.” His critical insight proceeded by way of simple syllogism: without private property in the means of production there can be no market exchange. Without market exchange there can be no (monetary) market prices. Without market prices indicating the relative scarcity of resources there could be no rational economic calculation. And without rational economic calculation, economizing behavior—indeed economy—is impossible. Hayek followed up on Mises’ argument with his “Use of Knowledge in Society” (1945), which highlighted that the key element was *information* about the relative scarcity of resources, which as Mises had showed



could only be reliably generated under a system of private property and exchange. The connection between the Mises-Hayek reasoning—written 45 and 20 years respectively before Kornai’s two-level planning paper—and Kornai’s own reasoning is quite clear. Although Kornai touches on the influence Hayek had on his thinking in this regard, as is unfortunately so often the case, Mises receives no credit at all. My point here, however, is not this one. It is the clear “Austrian-ness” of Kornai’s reasoning for the superiority of capitalism over socialism, an “Austrian-ness” which, as I argue below, only grew stronger as his research progressed.

## **4 Anti-Equilibrium and the Austrian Critique of Neoclassical Economics**

In the late 1960s Kornai turned his attention to a different, and quite remarkable, project for an economist whose exposure to Western economics at this point was exclusively neoclassical in its approach: a strident critique of the mainstream equilibrium theorizing. Kornai makes it clear that in each of his major research endeavors, indeed at each substantive stage of intellectual growth, he was driven by a concern for “the world outside the window.” Kornai did not receive formal economic training of any sort in the West. Although did formally study economics in Hungary, he is very much a self-taught political economist who relied on his own readings and discussions with interested friends and colleagues and simple observation of reality around him to inform his understanding of the economic world. His experiences and the reality of life that he encountered, not abstract theory, drove his thinking and work. In this sense Kornai actually benefited from his lack of formal training in Western economics, which, even at the time he would have been engaged in such training, was very much dominated by theory, and in particular equilibrium theory.

Indeed, one of the first sparks of Kornai's discontent with this approach, which he knew primarily from reading the likes of Western economists, such as Paul Samuelson, was the Walrasian world upon which Arrow-Debreu *and* market socialist proposals, including his own two-level version, were based. As Kornai puts it in his discussion of his two-level planning model, "One of the main factors reinforcing my [later] criticism of mainstream economic thought was precisely" its failure to engage in "verification of the model's assumptions and their comparison with the reality" (2007: 147).

Kornai's critique of neoclassical economics, which culminated in the 1971 publication of his appropriately-titled book, *Anti-Equilibrium*, had multiple prongs. The major attacks, however, bear a striking similarity in important respects to the arguments leveled by Ludwig von Mises in his 1933 book, *Epistemological Problems in Economics*, and his 1949 book, *Human Action*. These arguments were subsequently taken up by an entire generation of Austrian economists who railed against the sterility of equilibrium theorizing and the economic profession's attendant lack of attention to economic reality and to the market as a *process*. As Kornai summarizes his argument in *Anti-Equilibrium*, "My main objection was that the [Walrasian] theory, the multiplicity of research it instigated, and the comprehensive scientific program of mainstream economics failed to answer the *big* questions, to assist in a deeper understanding of capitalism and socialism" (2007, pp. 180-181). For Kornai, like for Mises, the world of equilibrium, or what Mises called the "evenly rotating economy," is an indispensable mental tool for understanding economic theory. But it is demonstrably not about the world we live in and cannot tell us about the actual economic problems—"the big questions" to use Kornai's language—we actually face.

The connection here is even stronger upon recognition of the fact that for Mises and Hayek, much like for Kornai, the real trouble with the equilibrium approach became apparent only in the midst of the debate about market socialism in which, perplexingly, socialists were using the neoclassical model—traditionally associated with market advocacy—to demonstrate the equal (or superior) economic efficiency of the socialist system (Kirzner 1987). Something must surely be wrong with the equilibrium mode of thinking, each of these thinkers independently reasoned, if it reduces economic reality to the point where socialism and capitalism effectively look and operate the same—where it is “immaterial whether we lived in a centralized or decentralized economy, under capitalism or communism” (Kornai 2007, p. 181).

Hayek made this point in 1937 in his less well-known but equally insightful precursor to the “Use of Knowledge in Society,” “Economics and Knowledge.” The marginalist equilibrium conditions that market socialists like Lange saw as the salvation for socialist efficiency are *outcomes* of the market process, Hayek pointed out. They are not preconditions going into economic activity that could instruct socialist producers how they should proceed. Stated differently, the formal efficiency conditions of competitive general equilibrium are *descriptive*, in ex post sense, of what the market process tends to move the economy toward in the context of a private property system of monetary exchange. They are not, nor can they be, *prescriptive* blueprints for achieving economic efficiency in the absence of this process. In stipulating from the start that socialist producers will set price equal to marginal cost and produce where average cost is at its minimum, Lange’s model assumes the very things it needs to prove. But of course, in a world in which production and consumption are already in equilibrium, which is the world of Arrow-Debreu upon which Lange was building, these features are by definition already in

place. Thus, as Mises, Hayek, and many years later Kornai, pointed out, the equilibrium approach is fatally flawed for considerations of comparative political economy.

Other important elements of Kornai's critique of the neoclassical approach will also ring familiar with those knowledgeable of Austrian economics. For example, he is highly critical of the strict, and many would say, sterile rendering of rationality in the mainstream view where preferences are fixed and transitive. Kornai also objects to the static nature of the equilibrium approach, which facilitate the homogenization capitalist and socialist political economy in the model. "Yet one of the essential differences between them lies in their dynamics. The competition in capitalism provides an impetus that pushes producers into continuous technical renewal. Socialism, in contrast, lacks the spontaneous force of competition: new products arise fitfully and reluctantly from the bureaucratic orders of central planners," Kornai points out (2007: 182). Such competition, however, can only come from a certain kind of institutional regime—namely one rooted in private property ownership. These sentences could have easily been written by Mises or Hayek in the 1940s.

Oddly, though, Kornai does not acknowledge any connection between his anti-equilibrium views and those of Mises or Hayek. He does complain that behavioralists, such as Daniel Kahneman, who won the Nobel Prize in economics in 2001 for pointing to real-world anomalies with respect to the predictions of the neoclassical rational choice model, "failed to mention *Anti-Equilibrium* as one of the theoretical-historical precursors to newer developments" (2007, p. 193). However, I found myself equally "disgruntled," as Kornai puts it, that the Austrian "theoretical-historical precursors" to Kornai's anti-equilibrium arguments are not mentioned in his book at all.

## 5 Concluding Remarks

I have considered only two major themes in Kornai's work that have strong Austrian connections. However, the description of other themes in his memoirs point to a number of others. Kornai's most well-known idea, the "soft budget constraint," for example, is also very much one with Austrian roots traceable back to Mises' 1944 book, *Bureaucracy*. It is even briefly touched on in his 1920 essay that kicked off the socialist calculation debate, where Mises argued that the absence of private property, and thus, market prices, and in turn profits and losses under socialism put firm managers in a position in which they neither reap the rewards of combining resources effectively nor incur the losses that would otherwise lead them to "go out of business." The result is a kind of moral hazard problem for socialist producers. Kornai's later and more thorough-going critique of socialism also very much reflects arguments made by Mises and Hayek, which are really institutional critiques rooted in the fundamental role of private property rights, which generate both the appropriate information for rational resource calculation and the incentives to act on that information in a capitalist economy, but as Mises pointed out are necessarily lacking in a sociality one.

Kornai's autobiography is therefore not only an interesting one for the story it tells in terms of Kornai's own intellectual evolution. It is also an interesting one in terms of (unwittingly) highlighting the relevance and validity of Austrian arguments for understanding the world. For these reasons, perhaps somewhat unexpectedly, Kornai's book will not only interest the "average economist," who has undoubtedly in some way or another been impacted by Kornai's important contributions to economics. It will also hold a special interest for Austrian economists who will both be struck by the correspondence between Kornai's ideas—and in several spots how he came to those ideas—and Austrian ones, as well as heartened that an

economist with the acclaim Kornai deservedly enjoys is, self-acknowledged or not, very much an Austrian.

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