

From Reformation to Transformation: Limits to Liberalism in Hungarian Economic Thought

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Introduction: The Swinging of the Pendulum?

"Closet capitalists" was the term used by sympathetic observers and neo-Stalinist critics alike to label the reform economists¹ in Eastern Europe. According to both camps, the market socialists were sui generis liberals who only spoke about "plan" and "market" because they were not allowed to speak about "market" *without* "plan." This interpretation may imply that with the opening up of the reformer closet, a legion of Hayek and Friedman clones will march out of it. Such expectations have been especially high as far as Hungary is concerned, whose economists were considered to be among the most radical representatives of socialist reform thinking.

At first sight, nothing would seem to challenge this prognosis: most reform economists in Hungary ceased to talk about "perfecting the economic mechanism" a long time ago, and in the last couple of years, they have even abandoned hope in the radical blueprints for market socialism. Instead of "reformation" (i.e., improvement within the old system), "transformation" (i.e., transition to a new system) is now the catchword of the day. The language of economics has become heavily

1. In Hungary we used to group the concepts of "decentralized planning," "market socialism," "self-managing socialism," etc., under the comprehensive term of "reform economics," in order to make a distinction between its representatives and the adherents of the Stalinist political economy of socialism. (In what follows, the expressions "reform economics," "reform theories," "reform concepts," and "reform programs" are used interchangeably.) Recently, I tried to reconstruct the analytical type of reform economics with the help of the concept of the "plan-and-market discourse." (Cf. János M. Kovács, "Reform Economics: The Classification Gap," *Diskalnia* 119:1 (Winter, 1990), pp. 215-49, and J. M. Kovács, "Compassionate Doubts About Reform Economics (Science, Ideology, Politics)," in János M. Kovács and Márton Tardos, eds., *Reform and Transformation* (London, 1991).) See also Section VI of this paper. For descriptive typologies of Hungarian economic thought, see János Kornai, "The Hungarian Reform Process: Visions, Hopes and Reality," *Journal of Economic Literature* 24 (December, 1986), pp. 1687-1744; László Lengyel, *Végfeljelen* (Budapest, 1989).

anti-etatist: the old reformist slogan of "creating markets *within* the party-state" has been swept away in a matter of months by a series of convulsive privatization programs. The rapid change in the general economic discourse suggests that there must have taken place a preliminary accumulation of liberal ideas² in reformist thought.

This metaphor "the swinging of the pendulum," has been widely used over the past decade to predict a neoconservative turn in Eastern Europe. Such headlines as "Maggie Thatcher goes East," "The New Right under Communism," "Hayek in Poland," and "Chicago Boys in Budapest" still crop up on the front pages of renowned Western newspapers, as well as in professional journals.³ The general expectations about the triumph of *laissez-faire* in the East are so powerful that even distinguished Western analysts with social-liberal leanings like Alec Nove have felt it necessary to issue repeated warnings to their colleagues from Belgrade to Moscow about what they think to be the disastrous conse-

2. In view of the prevailing confusion surrounding the interpretation of the concepts of liberalism, libertarianism, conservatism, neoliberalism, etc., I would like to state clearly that a.) in this paper I shall analyse the rediscovery of liberal economic thought primarily from the point of view of new classical liberalism (cf. John Gray, *Liberalism* (Minneapolis, 1986f); b.) this is not necessarily a matter of ideological preference on my part. Instead of advocating Hayek, Buchanan, Friedman, or Stigler to my colleagues, as a historian of economic thought I would like to examine which currents of Western liberal economic science are most likely to prove attractive for the Hungarian economists. To put it simply, are they likely to choose the neoclassical synthesis or rather one of its monetarist, neo-Austrian, institutionalist, etc. critiques? Or will some kind of third solution emerge again? (Cf. Jerzy Szacki, "A Revival of Liberalism in Poland?" *Social Research* 57:2 (Summer, 1990), pp. 463-93.

3. See, for example, Roger Scruton, "The New Right in Central Europe," *Political Studies* 3-4 (1988); Andrzej Walicki, "Liberalism in Poland," *Critical Review* (Winter 1988), or "What Is To Be Done," *The Economist*, January 13, 1990, pp. 19-24; "Rediscovering the Wheel," *The Economist*, March 24, 1990, pp. 15-17. See also Jacques Rupnik and Pierre Kende, "Liberalism et crise du système communiste en Europe de l'Est," *L'Europe* 15-16 (1988) and Elmer Hankiss, *Eastern European Alternatives—Are There Any?* (Oxford, 1990). Let me quote a few sentences from Rupnik's recent book, *The Other Europe* (London, 1988): "Another by-product of the economic crisis of the 1980s is the triumph of liberalism. . . . In the debate between Oskar Lange and Ludwig von Mises, Central Europeans voted with their feet for the free-market. Of course the miraculous healing powers of the market are all the more idealized for being out of reach. Nowhere can you find in Europe more orthodox disciples of Milton Friedman's free-market theories than in Poland. . . . Economic neoliberalism provides the most radical alternative to socialist planning. The attraction of the integral market varies from country to country, proportional to the degree of collapse of the economy. . . . From Tibor Liska, Professor at the Karl Marx University in Budapest and disciple of Milton Friedman, to Mirosław Dzielski, the leader of the neoliberal Association for Free Enterprise in Cracow, one finds a common reference to the Viennese School (Friedrich von Hayek, von Mises) and its extension, the Chicago School. It is part of rediscovery of an indigenous Central European liberal tradition which recognized the connection between the triumph of etatism and what Hayek called the 'road to serfdom.'" (pp. 190-91.)

quences of deregulation in the West. Similarly, János Kornai has also taken every occasion in the last few years to demonstrate anew his disagreement with the "socialist free-marketeters", and to keep his distance from the idea of the "minimal state."⁴

Meanwhile, his Harvard colleague Jeffrey Sachs, commuting between Poland and Yugoslavia with his "Big Bang" plan, helps reinforce in the minds of the superficial observers the old prejudice that the reform economists have always been prepared to administer economic shock treatment to the population. According to this prejudice, in the eyes of the "Eastern conservatives," mass unemployment, welfare cuts, etc., are only negligible risks of economic stabilization. "Selling out the country," "new Manchesterism," "primitive accumulation of capital"—the familiar neo-Stalinist criticisms are in fashion again. John Kenneth Galbraith touts Eastern Europe in the hope of dissuading the former reformers (let us call them *transformers*) from recreating nineteenth-century capitalism in the era of the "new industrial state." Conversely, Milton Friedman must be delighted to hear the new minister of finance in Czechoslovakia, Václav Klaus, speak his monetarist language. Friedrich August von Hayek's *The Fatal Conceit* will soon be published simultaneously with Zbigniew Brzezinski's *The Grand Failure* all over Eastern Europe. The social-democratic parties are losing the first free elections: the post-Communist countries are looking ahead to a Christian-democratic breakthrough, and the new governments are not importing their economic advisers from Sweden.

So the fears as well as the hopes seem to point in the same direction. The imaginary pendulum oscillating between collectivism and liberalism appears to be about to reach the right extreme of its movement. In what follows, however, I would like to show, using the example of Hungarian economic thought, that this impression may be misleading for two reasons:

First, although during the last three or four decades, reform economic thought has been dominant in Hungary, it has never been a monolithic force. Second, although during the last three or four decades, reform economic thought has been dominant in Hungary, it has never been a monolithic force. . . .

4. Cf. Alec Nove, "Markets and Socialism," *New Left Review* 161 (1987), pp. 98-104; and Nove, "Soviet Reforms and Western Neo-Classical Economics," in Kovács and Tardos, eds., *Reform and Transformation*. See also János Kornai, "Individual Freedom and Reform of the Socialist Economy," *European Economic Review* 32: 2-3 (1988), pp. 233-67. In his paper Kornai rejects the idea that the reformers are camouflaged Thatchers, but at the same time he also speaks about "liberal extremists" in the reformist camp. For a sharply worded attack on the "social-Darwinist leanings" of the Hungarian reformers, see Serge Larouché, "Hibás elméleti alapozott receptek," *Tenyek és Valóság* 1 (1985), pp. 31-41.

mists in Hungary have undoubtedly distanced themselves from the early project of “rationalizing Stalinism,” this evolution was not at all linear. The process of incorporating more and more liberal elements in the reformist discourse was not only disturbed by external, political factors, but there were also built-in obstacles to this kind of “liberalization” in the reformers’ scientific program itself, as well as in the ambiguous sociological position of the reform economists.

In other words, it was mainly unreconstructed socialists or sober pragmatists—and not secret agents of capitalism—who have been crouching in the reformist closet. Until recently, they did their best to invent clever techniques of (simulated) marketization which do not blankly call into question the primacy of state ownership and one-party rule. Thus, the expectation that socialist reformism will “develop into” liberalism through the opening of a door seems far too bold. A politically liberated reform economist is not *ipso facto* a liberal economist. He might well evolve into one, but the metamorphosis does not end but rather starts with the emergence into the open air (see Section I).

Second, accordingly, the disciples of “*reform economics*” (as the successor to reform economics may be termed) appear in Hungarian economic thought dragging along the burden of a kind of *deformed* liberalism from their reformist past. In addition, following the first flush of victory over the party-state, the liberal imagination of the economists may be soon tied down with the specific tasks of transformation. It may indeed turn out that the transition process cannot be successfully guided without large-scale intervention by the state (even if no longer a one-party state). Moreover, owing to the joint program of marketization/privatization and democratization (a *differentia specifica* of post-socialist transition), the economists may face the old liberal dilemma: what if the new democratic order votes down market liberalization? Why should the transformers not go on searching for halfway-houses: now between the “people” and the “market”, and not, as earlier, between the “nomenklatura” and the “market”? Reform-mongering may turn into a kind of bargaining over transformation programs, which will continue to keep off the scholars of abstract-analytical research into liberalism.

No doubt about it, “*social market economy*” has quickly replaced the notion of “*socialist market economy*” in the recent post-reform discourse

of the Hungarian economists. (Note that in Eastern Europe, *Soziale Marktwirtschaft* lends itself to a rather broad interpretation, including, among others, both Swedish-style socialism and German Christian-democracy.) At the same time, Thatcherism and Reaganomics are, tellingly, *not* among the standard references in Hungary. Most of the transformers are now opting for much more interventionist scenarios of the transition. In addition, they choose the more rather than the less social-oriented variants of *Soziale Marktwirtschaft*. But even if they accepted one of its less social and more liberal variants, they would still be far removed from, say, the Hayekian ideal of a “spontaneous extended human order.”

Hence the final conclusion of this paper that neither its past nor its present is likely to prepare economics in Hungary for a wide reception of new classical liberal thought, even if the current decomposition of real socialism provides strong empirical arguments against collectivism in the old debate about socialist economic calculation. Turning back on the “road to serfdom,” a new classical liberal would say, only means taking the first step on the road to freedom (see Section II).

Section I: The Legacy of Reform Economics

1 Locked into the Plan-and-Market Discourse

Recently, I made two attempts at the classification of socialist reform concepts: one on the basis of scientific variables, and another on that of political and ideological variables.⁵

Logical Difficulties When I approached reform economics from the point of view of its scholarly construction, I found its discourse controversial, even *irreparably* so. In examining the logical possibility of creating a new paradigm of economic science, a kind of Grand Theory along the Third Way, I arrived at the conclusion that in the reformist conceptual framework no more than a kind of “borderline-case economics” combined with a “middle-of-the-road theory of deregulation” can be constructed.⁶

5. Cf. Kovács, “Reform Economics”; and Kovács, “Compassionate Doubts.”

6. To be sure, this does not mean that the reformers are incapable of offering an authentic *in vivo* analysis of the market distortions in Soviet-type economies (shortages, investment cycles, overcentralization, etc.), which could otherwise only be examined *in vitro*, as borderline cases in a “normally” functioning Western market economy. Moreover, reform economists can also

In other words, once the economic theorists in a Soviet-type society accept

a) the basic compromise inherent in the program of limited liberalization within the party-state;

b) the logical structure of what I call the "*plan-and-market discourse*" (asymmetric combination of plan and market in favor of the plan, mechanical view of the market, "speculative institutionalism," indifference to property rights, market simulation, marketization "from above," etc.);

c) the contradiction between the essential constructivism of reform thinking and the evident lack of a final goal of the reform process, reform economics necessarily appears as a hybrid discipline of only partial validity.

Sociological Constraints Why were these shortcomings not eliminated in a learning process during the past decades? I found that, despite the obvious differences between, say, the early modest reform proposals for decentralization and the partial privatization programs of the radical reformers,

a) the scholarly refinement of the reform concepts did not follow necessarily the long-term political radicalization and ideological secularization of reform economics (reformers showed propensity to forget and reinvent, or simply get stuck between Stalinism and social-liberalism; the reform concepts were shaped by a learning-by-doing rather than a learning-by-reading process);

b) the pattern of radicalization depended on the *intermediary position* of the reform economists between political power and academic life, government and opposition, East and West.

They were caught in the well-known political paradoxes of economic reform (reform from above or from below? all at once or step by step? in a slump or during an upswing? etc.), so they could be elitist and

formulate genuine normative statements about how to liberalize and, at the same time, observe the rules of the party-state economics. Nevertheless, reform economics displays serious imperfections in both of these scholarly roles. As an analytical discipline, it operates with rather soft (speculative) categories of institutional inquiry. As regards its normative message, in its doctrine of deregulation the question of "where to" is blurred, and only the process of dismantling controls is discernible. Instead of going beyond the limits of the Soviet-type economy, this deregulation program provides instructions for how to maneuver in the middle of the road between less and more market-type socialisms.

democratic, authoritarian and populist, naive and radical during one and the same reform cycle. The reformers served many masters and became interested in institutionalizing their role as middlemen, while safeguarding reformation from transformation programs that point either toward the First or the Second Way.

As a result, the scholarly evolution of reform thinking was inhibited and unbalanced even within the boundaries of the plan-and-market discourse: the economists often became reform-mongers searching for new ideas depending on the success/failure ratio of reform-making. They experimented on a trial and error basis before resorting to Western literature. And the logical alternatives of market simulation are innumerable.

Why deny that the above conclusions were influenced by the more-than-thirty-year history of the Hungarian school of reform economics? Although I want to avoid passing judgment based on the wisdom of hindsight, I cannot help noting that as time passed, the sluggish progress of economics in Hungary could be less and less attributed to immutable extra-theory factors like political censorship, lack of international communication, etc. Unfortunately, the reform economists became prisoners of their own discourse. To support my reservations, here is a brief outline of the postwar history of economic thought in Hungary.⁷

2 How Not to Become a Liberal after Quitting Stalinism?

Learning-by-doing or learning-by-reading? It seems to me that until recently Hungarian reform theorists—with the exception of the mathematical economists—were adopting a surprisingly uncooperative attitude toward the economic profession in the West. Indifference may be a better word for it. Although in Hungary there were practically no ideological restrictions on "bourgeois" economics over the last twenty years, the reformers systematically left out of consideration a series of new schools in modern economic science.

Historically, such "proto-reformers" as Oskar Lange in the 1930s

7. This outline is not the end-product of an exhaustive historical survey of reform economics in Hungary. In drawing up this summary, I borrowed a great deal, despite all our disagreement, from the first interpretations of the history of Hungarian reform concepts by László Antal, Tamás Bauer, Iván T. Bertend, András Bródy, Róbert Hoch, János Kornai, László Lengyel, Aladár Madarász, and László Szamuely.

had faced the alternative of either accepting the Austrian critique of collectivism or choosing an apologia of rational economic calculation in market socialism along the lines of neoclassical reasoning. Some of the early reformers in Hungary at the end of the 1950s and the beginning of the 1960s started to accept the decision of their predecessors in favor of neoclassical arguments. But—after some hesitation—they left the neoclassical paradigm, and continued what most of them had begun in the mid-1950s, that is, to experiment with (speculative) institutionalist concepts within the plan-and-market discourse. Since then, the reform economists have had, in principle, *three options* for advancing scholarly research:

- 1) to revive the tradition of Austrian liberalism;
- 2) to revisit the neoclassical arguments and construe a general equilibrium model of market socialism, one that would be more sophisticated than that of Lange and his colleagues;
- 3) to refine the institutionalist message of the 1950s and 1960s with the help of new Western theories.

Without showing either relief or resentment, I venture to suggest that in Hungary a *fourth solution* triumphed. The second option was rejected without taking the first or the third one. The cracks in the neoclassical synthesis, as well as the appearance of those alternative liberal research programs which strove to fill them in even at the risk of sacrificing main wings of the scientific edifice, escaped the attention of the majority of Hungarian economists over the last fifteen-to-twenty-year period.

1 The eradication of liberal ("bourgeois") political economy The main representatives of liberal economic thought in Hungary either did not survive the War and the purges of the universities during the late 1940s and early 1950s (Ákos Navrátil, Farkas Heller); or they became absorbed in government activities; or (as in the case of István Varga) they died before non-Marxist doctrines were tolerated again. Talented young theorists, later to become outstanding representatives of social-democratic economic ideas (Tamás Balog, Miklós Káldor) left the country between the two wars. However, the bulk of those leading non-Communist economists who remained, were not *laissez-faire* liberals, either. They, too called for Keynesian-type state intervention; what is more, before and after the war, they cherished strong illusions concerning the corporatist

concept of "*directed (controlled) economy*" (Imre Vajda, István Varga, Béla Csikos-Nagy).⁸ Hence, the intellectual links with Western liberalism in economic science had been broken before reform economists started their careers in the 1950s with the aim of loosening the fabric of the "ultra-directed" Stalinist economy. The early reformers' only opportunity to meet eyewitnesses from the past was provided by the short-lived Varga Commission on economic reform in 1957, but here they "only" encountered a couple of non-Communists rather than devoted liberals.⁹

2 The Unexploited Possibilities of Rediscovering Liberalism in Economics Those who grew disillusioned with Stalinist political economy in the 1950s, were provided by reform economics—in its preliminary form of "decentralization instead of marketization and privatization"—with a solid shelter from the temptation of *laissez-faire*. In the Hungary of the late 1950s and early 1960s, following the shock of 1956, the pioneering reform theorists of the 1950s either converted to mathematical economics (input-output analysis as András Bródy, multi-level planning as János Kornai, foreign trade models as Márton Tardos); started to work on the theory of capitalism as Péter Erdős, the theory of economic growth as Ferenc Jánosy; became marginalized as Tibor Liska; or else plunged into the practical preparations for the New Economic Mechanism (NEM) of 1968 as György Péter, and Tamás Nagy.

Paradoxically, the NEM had not been anticipated by any major work of Hungarian economists. This reform relied on political speeches and short programmatic papers as well as on a great number of what we

8. See the paper of Tamás in this collection, and László Lengyel, "A gazdasági mechanizmus reformjáról," *Váltoág* 27:9(1984), pp. 88–96, and Lengyel, "Két személyiség a valóságban," *Váltoág* 29:10(1986), pp. 51–64.

9. Among the Marxists there were, of course, economists (István Fűst, György Péter, Imre Vajda) who were familiar with the basics of Western economic science. The organic roots of liberal economics probably could have been revitalized later through reading; if the teaching and writing of the history of non-Marxist economic thought were not monopolized in Hungary by representatives of the first generation after the purges (Antal Mátyás, Géza Ripp), from whom the reformers distanced themselves. Cf. Iván T. Berend, *Gazdasági utáreték, 1956–1965* (Budapest, 1983); László Lengyel, "A gazdasági mechanizmus," Lengyel, "Konceptió és kritika. A piaci szocializmus egy változatáról," *Váltoág* 28:9(1985), pp. 102–11; Lengyel, "Tőlátás szkepszis—leíró közgazdaság," *Váltoág* 28:10(1985), pp. 104–09; Részeg Nyers, "Péter György a kommunista és reformer," *Művelődés* 2–3(1984), pp. 247–53; László Szamuely, "The First Wave of the Mechanism Debate in Hungary, 1954–57," *Acta Oeconomica* 29:1–2(1982), pp. 1–24; Szamuely, "The Second Wave of the Economic Mechanism Debate and the 1968 Reform in Hungary," *Acta Oeconomica* 33:1–2(1984), pp. 43–67; Szamuely, *A magyar közgazdasági gondolat fejlődése* (Budapest, 1986).

called "official *samizdat*" produced by expert committees, rather than on profound theoretical synthesis. In the field of reform economics it was mainly Włodzimierz Brus and occasionally Ora Šik who served as fixed points of reference, in addition to Lenin and Bukharin portrayed, as ever when reforms needed ideological backing, as liberal Bolsheviks. Brus replaced Péter and Kornai, whose intellectual patterns from the 1950s he never denied following, but who had either interrupted scholarly work or, as in the case of Kornai, become sceptical about the allegedly laissez-faire illusions of the NEM reformers. As strange as it may be, in 1968, Kornai's *Overcentralization* written in 1956 could still easily have competed for the title of the best Hungarian book in reform economics¹⁰, while Tibor Liska, whose "Oeconostat" also could have served as a basis for a NEM-theory, was excluded from the think-tank of the 1968 reform under the accusation of being a free-marketier.

By and large, Hungarian reform thinking in the 1960s followed the intellectual pattern of the 1950s. No doubt about it, the economists managed to refine the main reformist concepts in the course of the preparations for the New Economic Mechanism. These concepts, however, were shaped by the practical requirements of introducing a comprehensive economic reform within the framework of the plan-and-market discourse, and not by the general theoretical requirements of liberal economic science.

In any event, after 1956 the politically deactivated reformers could have approached the liberal element in the neoclassical synthesis *through mathematical economics* if:

- 1) the new mathematical instruments had not also been apt to be applied within the framework of Marxian economics, following Leontief or Lange, in experimenting with the verification of the theory of labor value (Bródy), or with multi-level planning (Kornai);
- 2) the mathematical approach (which was influenced by "computopia" at the time) had not come up against the spontaneous institutionalism of the protagonists of the NEM (cf. Kornai's road from *Overcentralization* to *Anti-Equilibrium*, with a detour to planning theory);
- 3) the neoclassical paradigm had not already been challenged in the West, too, along the lines of institutionalist (behaviorist) arguments;

10. Cf. Berend, *Gazdasági utatársaság*; János Kornai, *Anti-Equilibrium* (Amsterdam, 1971); Szamuely, "The First Wave"; Szamuely, "The Second Wave."

- 4) Keynesian macroeconomics, an integral part of the neoclassical synthesis, which still seemed at that time infallible, had not justified state-interventionism.

These "ifs" help explain why Kornai, who had succeeded in breaking loose from Marxist teachings during the 1960s, proved unable to leave the plan-and-market discourse entirely and become a veritable liberal thinker until the end of the 1980s. Dissatisfied with the lack of realism of the assumptions made by general equilibrium theory, he was *uninterested* in entering the liberal tradition through the neoclassical ideas. Ironically, since the publication of his *Anti-Equilibrium* in 1971, whole generations of Hungarian economists have been introduced to the general equilibrium model through its critique. Kornai's polemical work had a paradoxical impact on the evolution of reform economics. Strangely enough, this was the first book in the history of Hungarian postwar political economy whose author wanted, based on an extensive knowledge of economics in the West, to open a dialogue with the adherents of the latter. Unfortunately, however, he could not manage to piece the "splendid isolation" of reform economics. Instead, contrary to his original intentions, Kornai *unburdened the conscience* of his Hungarian colleagues. Seeing his critique of the idea of perfect competition, they could feel reinforced in their role as reform-minded "planners" rather than "free-marketiers".¹¹ Kornai arrived, in a sense, too early in Hungarian economic thought: in the 1970s, the potential civilizing effects of the *Anti-Equilibrium* could not be fully exploited. His cautiously *non-Marxist-yet-non-liberal* attitude has seemed satisfactory to a large group of reform economists for years and years. His critique of the general equilibrium theory did not affect other parts of the neoclassical model, so the Hungarian reformers felt it appropriate

11. The coincidence of the publication in Hungary of the *Anti-Equilibrium* and John Galbraith's *The New Industrial State* caused liberal thinking to be regarded with even more suspicion for a long time. For János Kornai's attitude towards Galbraith in recent times, see Kornai, "The Hungarian Reform." For Kornai's warning to his colleagues about the need to read Western economic literature, see János Kornai, *Egyenlenség és demokrácia*. Bevezető K. J. Árvay *világosság* *tanulmányaihoz* (Budapest, 1979).

It is the misfortune of Hungarian economists that the Yugoslav reform model has proved (or seemed) to offer better opportunities than the Hungarian one for examination by means of the standard analytical tools of mainstream economics. Now there are dozens of models of the Illyrian firm in the literature, while the analytical pattern, different from what Lange proposed, of the Pannonian one is still lacking.

to turn to Keynes and to welfare economics for advice but almost never to Friedman or Hayek.¹²

Interestingly, the tacit dismissal of the Lange-Lerner model of market socialism as one of the unrealistic offshoots of neoclassical economics, has not led to the rediscovery in Hungary of the Austrian critique of socialism.¹³ What is more, the *Anti-Equilibrium* obstructed even that path which would have led to a deeper institutionalist critique of the general equilibrium theory, initiated among others by Kornai himself. Again contrary to his intentions, this critique seemed to have been completed once and for all. This is a reason why reform economists in Hungary did not show lively interest either in observing the new Western trends in the critique of neoclassical economics, or in deciding to what extent it succeeded in protecting its own integrity despite all the criticism. Yet institutionalist arguments played no minor part on both sides.¹⁴

Going back to the three unexploited possibilities facing the reformers, the observer cannot suppress a feeling of frustration. The Hungarian economic profession, which at the end of the 1960s was able to produce at least one work, *Anti-Equilibrium*, that addressed the principal problems of mainstream economics at that time (in a language that the adherents of the latter could understand), now—after two decades—is lagging far behind the West. Again, Kornai cannot be blamed for this. Continuing his institutionalist (behaviourist) research program, he was able successfully to invalidate a great number of speculative notions of reform economics in his model of the shortage

economy. Furthermore, from his essays written in the 1980s, the attentive reader can assemble a moderately liberal critique of the plan-and-market discourse as well.¹⁵

Thus, the Keynesian-welfarist conditioning was probably not as strongly rooted in his thinking, as it was in the mentality of most Hungarian economists.¹⁶ They did not seem to recognize that, with the appearance of the rational expectations theory (the “new classical economics”), the theory of deregulation, monetarism, and supply-side economics, as well as with the renaissance of Austrian liberalism, and the evolution of the concept of public choice (constitutional economics), they cannot afford not to clarify the reason why they were unwilling to reinterpret the idea of the Keynesian welfare state. To put it simply, referring exclusively to market failure became insufficient once we had learned about governmental failure. The temptation to borrow only a diluted variant of the concept of privatization from new liberal thought (“no Chicago—no Moscow,” to quote Alec Nove’s witty phrase), could be temporarily justifiable only from a political point of view.

No Chicago because of Moscow? But in that case, why did the Hungarian reformers not pay attention to those theories that are endangering the neoclassical synthesis to a lesser degree than the heavy artillery of new liberalism? *Game theory* is only one of the surprising victims. If carefully studied, it could have helped the reformers to understand the rules of bargaining, one of the underlying notions they

12. For Tibor Liska’s “Hayekianism” see Lajos Bokros, “Történelmiellen történelem” in István Sikláy, ed., *Konceptió és kritika* (Budapest, 1985), pp. 231–311, and László Lengyel, “Konceptió és kritika.” Kornai moves cautiously toward Hayek’s position (see Kornai, “Individual Freedom”). Márton Tardos first referred to Hayek in 1988 (Tardos, “A tulajdon,” *Közgazdasági Szemle* 35:12(1988), pp. 1405–23). See also Artília K. Sós, *Törv, kámpány, pénz* (Budapest, 1986).

13. Until recently, if someone wanted to read in Hungarian about the unfinished debate on socialist calculation, he would find no more than two sources: one basically pro-Lange chapter in the seminal book of Włodzimierz Brus, *Markes in a Socialist Economy*, and a couple of notes in Kornai’s works, mildly reproaching Oskar Lange for being the disciple of the general equilibrium school. Kornai needed long decades to break with Lange’s position in the debate of the 1930s. Compare, e.g., Kornai’s *Anti-Equilibrium* and “The Hungarian Reform.”

14. Cf. Irena Grosfeld, “Reform Economics and Western Economic Theory: Unexploited Opportunities,” in Kovács and Tardos, eds., *Reform and Transformation*; Nove, “Soviet Reforms.”

15. See János Kornai, “The Dilemmas of a Socialist Economy,” *Cambridge Journal of Economics* 2(1980), pp. 147–57; “Bureaucratic and Market Coordination,” *Osternya Wirtschaft* 29:4 (1984), pp. 306–15; “The Hungarian Reform”; “Individual Freedom.” For example, Kornai’s proposition about the “whirlpool of bureaucratic restriction of the market” is a remarkable exception in the reformist literature. It was only in 1987 and 1988 that Kornai embarked upon the examination of the relationships between individual freedom, property rights, and state power. Whether or not his normative considerations about a “medium state” went beyond the limits of the plan-and-market discourse was debatable at that time, because he did not explicitly advocate privatization until the publication, at the end of 1989, of his pamphlet about the transition.

16. The only discussion in Hungary in the 1980s recalling the debates between Keynesian and neoliberal economists in the West was provoked in Tibor Liska’s views on “entrepreneurial socialism” (see Sikláy, ed., *Konceptió és kritika*). During this discussion, Bertold, Kornai, and Tardos applied a number of conventional Keynesian arguments in their critique of Liska’s anti-statism. For the evolution of the views of Hungarian reform economists on the desirable extent of state intervention, see Márton Tardos, “Development Program for Economic Control and Organization in Hungary,” *Acta Oeconomica* 28:3–4(1982), pp. 295–315, and “The Conditions for Developing a Regulated Market,” *Acta Oeconomica* 36:1–2(1986), pp. 67–89. See also Laki’s paper in this collection.

use to describe economic behavior in Soviet-type societies.¹⁷ Or let us consider *Ordo-liberalism*—to take an example from pre-reformation times. The Eucken school offers a large historical and institutionalist tool-box for analysing the economic “orders,” that could have complemented the original cybernetic approach in reformist thought. The same applies to the discipline of *Comparative Economic Systems*, which could have helped the reform economists to avoid making superficial comparisons (cf. convergence hypothesis), and to recognize the fine web of interrelated subsystems (ownership, control, coordination, motivation, information, etc.). As a consequence, quite a few illusions concerning partial reforms might have been dispelled in advance.

Similarly, “property rights” (*transaction costs*) economics, the “theory of the firm,” and the economic theory of bureaucracy, etc., that is, the intertwined disciplines of “new institutionalism” also could have assisted the reformers in understanding organizational changes in the market before they make proposals for deregulation. Moreover, these theories could have convinced them many years ago of the incompatibility of the party-state with the market, and of the importance of legal arrangements favorable to entrepreneurship, primarily that of property rights. Finally, the new institutionalist concepts could have directed the reformers’ attention to the issue of rivalry versus state intervention, and, perhaps, made them reformulate their old views on market failures.¹⁸

As far as the theory of bureaucracy in concerned, reform economics in Hungary tended to stop at Max Weber, while institutionalist thinking about the market frequently used Karl Polányi (if not Galbraith) as

17. János Kornai and Tamás Lipiák briefly experimented with game theory in two-level planning. Kornai took up the idea of “plan bargaining” in his *Economics of Shortage* (Amsterdam, 1980) but here he borrowed Hirschman’s concepts to portray the bargaining process. Tamás Bauer, *Tervezési verseny, szilárd és rugalmas* (Budapest, 1981), and Ártilla K. Sós, *Tev, kampany, pénz*, insist on a strictly empirical description of the game.

18. Bornstein, Montias, Neuberger, and Duffy, or Alchian, Demsetz, Furuborn, Niskanen, Olson, Pejovich, Tullock, and Williamson—to name only some of the authors who write on comparative systems and institutionalist concepts—are quoted very rarely in Hungary. The attempts made by the Marburg economists or Pejovich at applying the new-institutionalist concepts in the understanding of Soviet-type economies, are similarly neglected. See, for example, Helmut Leopold, *Wirtschafts- und Gesellschaftssysteme in Vögelin* (Stuttgart, 1988); Swetozar Pejovich (and Erik Furuborn), “Property Rights and the Behaviour of the Firm in a Socialist State,” in Furuborn and Pejovich, eds., *The Economics of Property Rights* (Cambridge, 1974), pp. 227–52; Pejovich, “The Capitalist Corporation and the Socialist Firm,” in Karl Brunner, ed., *Economics and Social Institutions* (Hague, 1979), pp. 131–62; Pejovich, “Liberty, Property Rights and Innovation in Eastern Europe,” *The Cato Journal* (Summer, 1989), pp. 57–71. See also Grosfeld, “Reform Economics.”

an ultimate point of reference.¹⁹ Even Hirschman was not able to gain much popularity with his exit-voice-and-loyalty model. Or let us take more militant critiques of the general equilibrium theory: Leibenstein’s “X-efficiency” hypothesis or Simon’s concepts of “satisficing” and “bounded rationality.” And no serious reflection on the part of the reformers.

Paradoxically, reform economics in Hungary did not elaborate even on the older concepts of market failure (monopolies, public goods, externalities, etc.) widely used in welfare economics to justify state intervention. In other words, reformers tended to disregard even those categories which could balance Chicago-type arguments in the eyes of Moscow. (Did they have to camouflage themselves before the liberals, too?) What is even more interesting, selective reading was also lacking. For example, a number of neo-Austrian ideas (focusing on the entrepreneur, a dynamic approach to the market, the enhanced role of knowledge and information), as well as Buchanan’s views of governmental failure could, in principle, be easily transplanted to reform economics, if one took them out of their original contexts and stressed their similarities with certain elements of Marxian political economy (e.g., entrepreneurship, market as a communicative process, significance of property rights, etc.).²⁰

3 *Toward Liberalism Through Reform-making* After the publication of *Anti-Equilibrium*, the neoclassical paradigm probably would not have

19. For the impact of Max Weber, see the writings of András Hegedűs in the 1960s and 1970s, as well as Kornai, “Bureaucratic and Market Coordination.” Recently, Iván Szelényi has made attempts at combining Polányi’s concept of a mixed economy with a new Third Way scenario for Hungary. See Szelényi, “Karl Polányi and the Theory of a Socialist Mixed Economy” (1988, mimeo); “Eastern Europe in an Epoch of Transition—Towards a Socialist Mixed Economy?” in Victor Nee and David Stark, eds., *Remaking the Economic Institutions of Socialism* (Stanford, 1989), pp. 208–32; “Alternative Futures for Eastern Europe: The Case of Hungary,” *East European Politics and Societies* 4:2 (Spring, 1990), pp. 231–55.

20. The reader may ask why I disregard Tibor Liska’s oeuvre when discussing the rediscovery of the liberal tradition in Hungary? My answer may seem rather tactless. Liska is, in my view, both an agent and a tragic victim of provincialism. Instead of rediscovering, he has been reinventing liberalism, as a talented but—as he proudly declares—superficially educated economist. He succeeded in directing the attention of many of his colleagues to the problems of property rights, entrepreneurship, rivalry, economic freedom, etc., but he immediately wrapped these issues in a—basically socialist—utopia protected by emotional arguments. Cf. Bokros, “Történelmi modell”; Lengyel, “Konceptó és kritika”; Tibor Liska, “Liberalis hirtelenség a szocialista vállalkozás elméletében,” *Művelődés* 2–3 (1983), pp. 277–95; Liska, “Reform és kísérlet,” *Művelődés* 3 (1986), pp. 67–81; Liska, *Szociális gazdaság és politikai alapelvei* (Budapest, 1989); Siklaky, ed., *Konceptó és kritika*.

disappeared from the scene of Hungarian economic science if the reformers had not got involved in the *defense of the ailing NEM*. In the early 1970s, a group of Hungarian economists who grew frustrated by the slowdown of the 1968 reform, embarked upon an *expressly empirical* research program in order to reveal which institutions of the Soviet-type economy jeopardize the process of marketization. Despite the fact that most of these scholars were not consulting thoroughly the results of "new institutionalism" in the West (hence the reinventions), they managed to explore important features of the socialist economic system: lasting shortages, sharp investment fluctuations, hierarchical bargaining, oversized state redistribution, the symbiosis of the industrial monopolies with the party organizations, huge shadow economy, etc.²¹

Of course, many of them suffered from the analytical "softness" of reformist thought in the course of empirical research. Nevertheless, in the light of *Anti-Equilibrium*, they did not put much store by the instruments of mainstream economics: if they were sceptical about the relevance of the general equilibrium theory in the West, they showed a double dose of caution when it came to assessment of its validity in the East. Concepts such as equilibrium, perfect information, *homo oeconomicus*, etc., seemed to be totally unacceptable for the reformers in the description of an economy where slacks, frictions, and imbalances

21. As regards the reinventions, I think that Tardos's experiments with the concept of "property rights" and Kornai's notion of "bureaucratic coordination" fall under this heading, even if they openly acknowledge some of their intellectual predecessors. (See Kornai, "Bureaucratic and Market Coordination"; Tardos, "A tulajdon.") In any event, Tardos was the first to realize the flaws of limited liberalization, demanding the restructuring of property rights and the establishment of real capital markets (see Tardos, "A gazdasági verseny problémái hazánkban," *Közgazdasági Szemle* 19:7–8(1972), pp. 911–26). Bauer and Sós, despite the impressive empirical basis and explanatory power of their works on investment cycles, neglected the analytical refinement of such central categories of their studies as "direct plan relationship" and "campaign." (Cf. Bauer, *Tengzártság, bomlás, átlépés, csúszás, Sós, Terv, bomlás, pénz*.)

From the extensive literature of "new empiricism" the work of László Ánall on government behavior and that of Mihály Laki on enterprise behavior are particularly noteworthy. The following names come to my mind first in compiling the list of those empirical-minded Hungarian economists who maintain close contacts with the leading reform economists mentioned in this paper: Mária Csánádi, István Csillag, István R. Gábor, János Gács, Péter Galasi, Károly Fazekas, Annamária Izelt, Pál Juhász, Gábor Kertesi, János Köllő, Mária Lackó, Terezy Laký, Kamilla Lányi, Iván Mejor, Iván Schweitzer, Erzsébet Szalai, Pál Valentiny, Péter Vince, Éva Voszka. Gács and Lackó, as well as Galasi and Kertesi, are probably the most dissatisfied with exclusively verbal description, and are therefore making the first attempts at matching macro- and micro-economic models to the respective empirical material.

prevail, and where the notion of rationality is strongly linked to the species of *homo politicus*.²²

Our comparative advantage (more romantically: our duty) lies in learning, down to the smallest detail, what socialist economies look like, and let our Western colleagues become the "educated liberals." After having got rid of the empty abstractions and false deductive techniques of Stalinist political economy, we want to have tangible scientific results attained by inductive methods. We would like to define the analytical concepts which conform to our—unique—reality²³, or so said this group of reformers.

This upsurge of empirical research coincided with further frustrations during the reform cycles of the 1970s and 1980s. Reform economics made a big advance toward its own defeat through the reform

22. This is not the first time in this paper that I find it extremely difficult to situate Kornai in the Hungarian system of coordinates. The influence on empirical research of his *Overcentralization and Economics of Shortage* is indisputable. Nevertheless, Kornai himself introduced the latter book with apologies, saying that it contained a set of theoretical hypotheses that can be tested empirically, rather than a theory proved by empirical means. At the same time, some of his central concepts used in the analysis of shortage have also been criticized by logical means (see Kornai's discussion with Sós about the notion of "budget constraints"), not to mention the reservations many radical economists had about the softness of the "paternalism" concept used by Kornai in explaining the behavior of the party-state. (Cf. János Kornai, "On the Explanation Theory of Shortage," *Acta Oeconomica* 34: 1–2 (1985), pp. 145–64; Artile K. Sós, "Árnyposzt az Értékelési Előzményekhez," *Acta Oeconomica* 3–4 (1984); "A Répintézet János Kornai," *Acta Oeconomica* 1–2 (1985), pp. 162–64.

23. In order to arrive at this level of pragmatism and empiricism, they had to distance themselves from the original Marxist/Stalinist vision of "socialist commodity production." See Tamás Bauer, "The Science of Economics and the East European Systems," in F. and L. Silinitsky and K. Reyman, eds., *Communism and Eastern Europe* (New York, 1979), pp. 144–47; Bauer, "A kelet-európai tervgazdaság politikai-gazdasági értelmezéséhez," *Műveltség* 2–3 (1982), pp. 189–99; Bauer, "The Second Economic Reform and Ownership Relations," *Eastern European Economics* 3–4 (1984); Róbert Hoch, "Gondolatok szocialista értékszerkezetéről," *Társadalmi Szemle* 11 (1982); Rózsa Nyers, "Peter György". That this has been a lengthy process is shown by the answers of Béla Csikós-Nagy, Róbert Hoch, Ferenc Kornai, and Tamás Nagy to the questions of *Acta Oeconomica* "On Socialist Market Economy," *Acta Oeconomica* 3–4 (1989). For a critical view of the relationship between Marxism and reformism, see György Benec and János Kis (Marc Rakowski), *Towards an East-European Marxism* (London, 1978). For empiricist attitudes, see Márton Tardos, ed., *Vállalati magatartás, vállalati környezet* (Budapest, 1980); Lengyel, "Tőlélis székszisz." For the large gaps in and the analytical constraints of the empirical research of economic institutions, see Kovács, "Compassionate Doubts." It is interesting to note that sometimes even empirical-minded Hungarian economists get involved in rather speculative argumentation, as in the case of Bauer's "neither plan—not market" concept or Kornai's compromises between efficiency and socialist morals (cf. Bauer, "The Second Economic Reform"; Kornai, "The Dilemmas.") See also the recent debate among Hungarian reform economists about "recentralization" (László Ánall, Iván T. Berecz, László Szamuely, "A Debate on the Crisis of the Hungarian Reform in the 1970s," *Acta Oeconomica* 40:1–2 (1989), pp. 105–63.)

process itself, that is, through the consecutive failures of limited liberalization attempts. The plan-and-market discourse was discredited in Hungary by successive approximation. The reform economists recognized that, even if they are allowed to change the plan/market ratio gradually in favor of the latter, they arrive at a point beyond which future marketization is inconceivable without substantial privatization and political pluralization, that is, without moves that are alien to the original reformist discourse.

However, it took the Hungarian economists a long time to get out of the dead-end street of *compartamentalizing the reform program* into the limited concepts of optimal planning, fine-tuning of the mechanism regulators, modernization of the structural policies, simulation of the world market, restructuring of the economic organizations, introduction of self-management, monetization of the economy, etc.—one after the other. There was always some chance for second-best partial reforms delaying the “crucial” one. In any event, seeing the unexpected ability of the plan to reconstitute its power within the plan/market combination, reform economists were given additional impetus to investigate the real causes of the economic strength of the party-state.

In the course of reform-making, the economists underwent a process of *political* education in liberalism. They learned how the party-state works, and began to doubt the purpose of future compromises. They discovered the oligarchical structures of the nomenklatura, grew—though rather slowly—disillusioned with self-management, and started to long for parliamentary democracy. They could not decide to what extent the economy should be marketized and privatized but they knew for certain that the one-party rule must be replaced by the rule of law if they wanted to make the economic reforms irreversible. They also recognized that the shadow economy cannot produce free entrepreneurs if the civil society is not liberated politically. Unfortunately, however, they lacked a theoretical framework that could connect their empirical knowledge of the Soviet-type economy with their incipient political liberalism. In fact, they missed what they had turned their backs on in the early 1970s thanks to the historical coincidence of the critique of the general equilibrium theory and the slowdown of the New Economic Mechanism.

To sum up what we have, instead of what we lack, the list does not seem to be long. Now, at the end of the 1980s and the beginning of the 1990s, we are not well-acquainted with new liberal schools in the West

but we have Liska with his “entrepreneurial socialism”; we do not have a general equilibrium theory of socialism but we have Kornai with his disequilibrium model of shortage; and we do not borrow much from among the “new institutionalist” concepts but we have our own “new empiricism” mixed with the political experiences of reform-making.

Section II: The Origins of Transform Economics

1 Deformed Liberalism

The liberal aspirations of the radical reform economists may be blocked by the inherent *statism* (elitism, interventionism) and *constructivism* of reformist thought. The reformer wants to “introduce,” to “build up” market economy, and—paradoxical as it may be—asks the regulators to help deregulate. The reform economist always has a positive reform program, a “master plan” to experiment with, and finds the idea of “*leben und leben lassen*” inadmissibly passive. The reformer’s nightwatch-state is also awake during the day.²⁴ Nevertheless, because he lacks a definite image of the future (where does the Third Way end?), these positive programs tend to focus on the initial steps and the process of reformation rather than on its final stages. Consequently, if it makes sense at all to speak about liberalism in this context, reform economics embodies a sort of progressional liberalism, rather than a liberal discipline derived from a definite—though abstract—ideal vision of the future or the past.

Even the more radical reform concepts do not rely on a profound philosophical (ethical) basis, on strong arguments about the intrinsic “beauties” of the market and the virtues of private property, that is, on a radical liberal dream. Instead, the reformer sees the market in a *pragmatic-utilitarian* way as a device for “repairing” the Soviet-type economy. In his view, the market does not embody justice in itself. It is, however, capable of working as a machine (cf. the term “economic mechanism”) which is geared, or even at times switched on and off, by

24. For the differences between “positive” and “negative” reform attitudes, see the Klaus-Jeřek paper in this collection. An important exception to positive reform programs is “privatization through the second economy,” an idea that was rather popular in Hungary during the 1980s (see Section III/2). See also István R. Gábor, “Reformok, második gazdaság, államszocializmus,” *Váltoág* 24:7 (1986), pp. 32–49; László Lengyel, *Végérfeljár*; Iván Szelényi, *Socialist Entrepreneurs* (Madison, 1988).

the planners. This sterile notion of a market purged of property rights lends a *mechanical* character to reformist liberalism.

No doubt about it, these deformations have been considerably reduced in Hungary in the course of the learning-by-doing process outlined above. Nonetheless, liberalism in reform thinking has remained *rootless* in a double sense. On one hand, as we have seen, the liberal tradition in economics in Hungary was weak or broken; on the other, it was not reconstructed by importing or reinventing the basics of Western liberalism. In the absence of a firm philosophical background²⁵, the trial-and-error procedures of reform-making could only lead to a pragmatic (profane) rediscovery of liberal thought. Liberal ideas resulted from practical choices, I would say, for want of a better solution, and were often against the moral conviction of the reform economists.

To be sure, the romantic anti-capitalist feelings inherited from Marxist teachings by the early reformers began to wane as the years passed. Churchill's bon mot that democracy is the worst except for all other political systems, however, is still very popular in Hungary whenever economists discuss private property and the free market. Marketization and privatization tend to be considered musts, but they are regarded as necessary evils rather than "the best of all possible worlds." The latent animosity even some radical reform economists feel toward the "inhuman" market is supported by traditional arguments that defend the principle of equal opportunity.²⁶ *Egalitarian* considerations (whether they came directly from the Marxian utopia of communism, Western social-democratic thought, or from recent critiques of new classical liberalism) always permeated reform thinking, even when liberal views did not need to hide behind the facade of post-Stalinist ideology. True,

many reform economists in Hungary have since suspended their egalitarian vigilance, arguing: first we must create the market in order to humanize it later.²⁷

2 Privatization: With Mixed Feelings

We have seen that the "new institutional economics" which could have provided the idea of a link-up between the concepts of the market and private property, escaped the attention of the Hungarian reformers.²⁸ What disadvantages may arise if this idea proves itself in a trial-and-error process? Disadvantages? Obviously, practical experience leads to the firm conviction that the decomposition of the party-state is a sine qua non for taking further steps in market liberalization. This experience, however, does not offer reliable instructions as to the ways and means, or the appropriate degree ("a point of no return") for reducing state ownership. Hence the wide divergence of opinion among Hungarian economists in the second half of the 1980s on how to dismantle the party-state.²⁹

27. Even nowadays you would hardly find any "Thatcherites" in the reformer's camp. The names of certain reformist experts did become identified with policies that the government pursued in an attempt to manage the deep economic crisis of the 1980s by curbing welfare programs, reducing real wages, etc.; there is still no valid reason to label them "Thatcherites." The only thing their proposals had in common with "Thatcherite" policies was their direction: even if these proposals had been fully implemented, they would never have reached the departure point in marketization and privatization from which Mrs. Thatcher's governments launched their deregulation programs. Cf. Zsuzsa Ferge's critical remarks on the reformers (Ferge, "Gazdasági reform, szociálpolitika, legitimáció," *Vallás* 10 (1986), "A negyedik út," *Vallás* 4 (1989)).

28. It would be worth knowing why the reform economists continue to be reluctant to adopt certain conclusions of the property-rights theorists in the West. The reformers inherited a special interest in the historical interpretation of "production (ownership) relations" from Marxism. During the last thirty years, they have repeatedly proposed rearranging the "bundle" of property rights (true, only within the state sector). They have also recognized the imperfections of those ownership structures that fail to secure the exclusive and transferable nature of property rights.

Were the reform economists frightened by the extreme individualism of the property-rights theory, or by its disciples' strong arguments for exclusive private ownership in many fields of the economy? Or did they simply believe that the Soviet-type firm is in a sense more "private" than the capitalist one (bargaining, second economy, etc.)? See Comisso's and Grosfeld's papers in this collection.

29. See Lengyel, *Végkérdések*. This is the only comprehensive overview of the radicalization process in Hungarian reformist thought during the 1980s. For the sociological components of this radicalization, see Kovács, "Reform Economics." See also Iván T. Bertold, *A magyar gazdasági reform útja* (Budapest, 1988) and Sándor Kopátsy, *Lenél a magyar reformerokhoz* (Budapest, 1989).

25. Cf. Tamás's paper in this collection. In Hungary the democratic opposition was an important source of liberal thought for the radical wing of the reform economists during the 1980s. This source provided, however, anti-totalitarianism, democratic socialism (István Bibó), and an egalitarian critique of libertarianism rather than new classical liberalism per se. See János Kis, *Vannak-e emberek jogainak?* (Paris, 1987); Mária Ludassy, *Szabadság, egyenlőség, igazságosság* (Budapest, 1989). The message transmitted by the opposition came from Popper's *The Open Society and its Enemies* rather than from Hayek's *The Constitution of Liberty*.

26. The concepts of "optimalization" and "humanization" had already been set in opposition to each other by Andás Hegedüs back in the 1960s. Kornai took up the same line of thought several times when he discussed the dilemmas of marketization during the 1980s. The "taming" of the market is still regarded by the former reformers as one of the principal merits of the social-democratic mixed economies in the West. See Andás Hegedüs, "Optimalizálás és humanizálás," *Vallás* 3 (1965); Kornai, "The Dilemmas"; Kornai, "Individual Freedom"; and the survey of Ágnes Orosz, "On Socialist Market Economy."

The mushrooming of half-hearted programs of privatization was partly due to the fact that it was not the state as such but rather the *party-state* that became discredited in the reformers' eyes during the protracted process of learning by doing.³⁰

1) The failure of the reforms could easily be traced to the vested interests of well-identifiable lobbies, i.e., large firms, sectoral ministries, and trade unions that could not be so powerful without being cemented by party rule. Whereas it was also well known that from time to time main groups in the economic government fell victim to the conservative wing of the party. (Above all, it was in the functional ministries that the reform-minded leaders formed tactical alliances with the reformist academics.)³¹

2) In the West the Hungarian economists saw a great many state-owned enterprises (among them huge government holdings) that were earning profits. Approaching the deregulation measures in Britain or in the United States from a practical point of view, the reformers could until recently refer to the examples of Japan, Austria, Italy, or Sweden where the state sector had saved its integrity; or to the NICs whose quick successes could be attributed in part to strong state intervention.

3) In regard to their own experience in "socialist privatization," the shadow economy as an alternative to state ownership failed to convince the Hungarian reform economists. The relative strength of clandestine private property in the shadow economy could also be explained by the "parasitic" behavior of the "black" firm in symbiosis with the "white" one. Moreover, due to legal restrictions on the size of firms in the shadow economy and on capital transfer, private property was never allowed to prove its abilities on large-scale or in capital-intensive industries in the course of the reforms.

To sum up, if the idea of private property emerges almost exclusively from real-socialist experience, there is always room for arguments that support statism (collectivism).³² Hungarian reformist thought of

30. A remarkable exception is András Bródy (besides Tibor Liska, of course). See his critical remarks on Kornai's transition program, Bródy, "Tündés egy indultatásról kapcsán," *Váltság* 33: 3 (1990), pp. 11–15. See also Tibor Liska, *Szent baromok*.

31. Cf. János M. Kovács, "A reform-alku sürüjeben," *Váltság* 27:3 (1984), pp. 30–56; "Reform-Bargaining in Hungary," *Comparative Economic Studies* 28:3 (1986), pp. 25–42.

32. This support need not rely on the remnants of the anti-capitalist tradition. Nevertheless, the concept of self-management which appeared in Eastern Europe as the collectivist rival of privatization in dismantling the state was not discredited among Hungarian reform thinkers for a long time. The Yugoslav reform model had ceased to appeal to the Hungarian econo-

fered a jumble of "non-private" concepts of dismantling the party-state during the 1980s, whose authors were united only in their wish that the party should withdraw from the management of economic affairs, and in their demand that firms should be separated from state authorities. A number of self-management schemes and models of simulated state ownership (not to mention Liska's new entrepreneurial projects) were initiated by the reform economists, even after the Kádár regime had begun to collapse.

For instance, Bauer did not distance himself from his 1982 program for self-management for many years and Soós continued to advocate self-management in 1986 and 1987. (This idea was also an important component of the "Social Contract," the democratic opposition's first major program at that time.) In 1988, Antal, Kopátsy, Marolcsy, Sárközy, and Tardos, while doubting the virtues of self-management, still believed in state holdings, cross (or plural) ownership, etc., that is, in creating a capital market within the framework of the state sector. Finally, in 1989, Kornai who had scornfully called this market a "plastic Wall Street," proposed the immediate reprivatization of no more than one fifth of the state assets, and spoke cautiously of a private sector which might become larger than the public one within five to twenty years.³³ Ironically, in the meantime some of his colleagues whom he criticized have changed their minds, and are now stressing only the short-term practical limits of privatizing the overwhelming majority of state enterprises.

mists back in the 1960s when they were designing the New Economic Mechanism. Yet, they might assume that in the case of self-management, in contrast to the shadow economy, the weaknesses rather than the strengths resulted from the coexistence with the party-state.

For lack of space, I cannot discuss here the Hungarian intellectuals' ambivalent attitudes toward the market. The egalitarian traditions mentioned above indicate only one side of the problem, because in the past decades the reform economists were not reluctant intellectually to assist embourgeoisement, management, and the emergence of the civil society in general, even when party hard-liners did their best to criminalize the small entrepreneurs. Big business is, however, quite another matter. . . .

33. See Lengyel, *Végeljárás*; Kornai, *The Road to a Free Economy* (New York, 1990); Tamás Bauer, "Melyik a reális illuzió?" *Figyelő*, December 14, 1989, p. 3; István Csillag and Attila K. Soós, "Magányos kiadó?" *Figyelő*, January 25, 1990, p. 6; Kamilla Látyi, "Látomás és indulat a közgazdasági tanokban," *BUKSZ* 2:2 (Summer 1990), pp. 180–86; István R. Căbör, "A magánvállalkozás és polgárosodás kitérőiről," *Váltság* 33:6 (1990), pp. 49–55; Tardos, "A tulajdon"; János Kis, Ferenc Kőszeg, and Oritila Soli, "Társadalmi Szerződés," *Beszélő* (June 1987); László Antal, Lajos Bokros, István Csillag, László Lengyel, György Marolcsy, "Fordulat és reform," *Közgazdasági Szemle* 34: 6 (1987), pp. 642–708.

During the last two years, the reformist closet has opened up in Hungary, yet many transformers found themselves intellectually unprepared to "think big" about privatization. Apparently, they have been bothered by the familiar dilemma of "how to remake an aquarium from a fish soup."

3 Theory of the Transformation or Theory in Transformation?

Although in the case of the former reformers the theoretical (not the political) value of sudden revelations concerning private property may be doubtful, deformed liberalism is not fatal: one can manage to leave the plan-and-market discourse for a less deformed one. It is, however, rather time-consuming for the transformers to catch up by reading the authentic authors in liberal economic science, and to become capable of switching from eclectic and imitative research programs to original ones. Scholarly investments tend to have long gestation periods even in the case of "scientific revolutions." Strangely enough, even the succeeding generations of economists who, we hope, will not be affected by socialist reformism, should be persuaded to avoid a romantic tabula rasa approach to the future of economics in Eastern Europe. For the transformation process itself may become a source of additional obstacles to hinder the expected liberal upswing in economic thought.

1 Economists in the Parties: Back to the Closet? Whether one likes it or not, the path connecting the reformer and the transformer discourse leads through the tunnel of politics, and you can easily get stuck in it. The elaboration of reform policies in the past helped the Hungarian economists discover certain liberal concepts in economics; the radical reformers learned the liberal values of politics from their friends in the democratic opposition; and the recent political turn gave the reform economists the last push to leave the plan-and-market discourse. With the emergence of the parliamentary parties in Hungary, a large part of the former radical reformers joined the social-liberal party, the Alliance of Free Democrats (with whom they had already cooperated under Kádár). For the last two years they have been almost completely absorbed in day-to-day political activity. As for academic work, instead of writing thick volumes, they formulated slim party programs and performed advisory functions. From the point of view of the sociology of

science, this reminds the observer of their former role played in the reform commissions.

Revolutions are over after a while, and the economists return to their research institutes and universities. (In this context, the Free Democrats' election defeat may well save economic science in Hungary.) Nevertheless, the scientific problem of how to reconcile—for example, on the basis of *moral egalitarianism*³⁴—the classical liberal and social-democratic views in economics, which are simultaneously represented by the party, will remain unsolved. A temporary reconciliation might rely on the assumption that libertarians and egalitarian liberals (to use the typology by the president of the Free Democrats, János Kis) can reach a consensus without great difficulties at the beginning of the transition period when it comes to the destruction of the party-state. In any case, Kis's strong assertion that moral egalitarianism is more viable in terms of practical flexibility and also fits the intellectual traditions of Eastern Europe better than libertarianism, anticipates a future *Ribungstrei* within the party.³⁵

For the time being, it seems unlikely that the stimuli the former reform economists receive from their new party will be more liberal than social in nature. On the Hungarian political spectrum there is a *large gap on the left of center* that the liberals may well be tempted to fill. According to their manifesto, the Free Democrats are united in: firmly rejecting any ideology of the Third Way (popular capitalism, smallholder and self-management schemes, etc.); demanding a mixed economy which is dominated by—possibly personifiable—private ownership; and not discriminating against foreign capital in a rapid privatization process. However, they have not yet made it clear which model of modern capitalism they want Hungary to adopt. What does the dominance of private property mean: 51 per cent or—horrible dirru—99 per cent? The references in the party programs to employee shareholding, co-determination, the institutional forms of capital own-

34. See János Kis, *Vannak-e embert jégink?*

35. See Tamás's paper in this collection and the survey of Szabadkú about social democracy ("Beszélgetés a szocialdemokrataival": András Kovács, Mihály Vajda, György Bence, György Liván, Péter Kendé et al., *Szabadkú* 1 (1990), pp. 101–28.

The tiny "libertarian" faction within the party of the Free Democrats embarks upon this controversy under a heavy handicap: no leading member of the "old guard" of radical reformers has joined them yet. True, the "libertarians" still may hope for some reinforcement from the Young Democrats, the FIDESZ.

ership, the dominance of the public sector in health care and education, etc., indicate that the Free Democrats are searching for compromises somewhere between Bad Godesberg and Chicago (probably closer to the former than to the latter). It is not only for tactical reasons that they reject the neoliberal picture drawn of them by the rival parties. As they state in their election program, achieving the predominance of private ownership "is not a question of following abstract models."³⁶

Understandably, the radical reformers feel quite comfortable in such an intellectual climate, perhaps, *too comfortable*. They are currently including ideas in their transformation proposals which could not be squeezed into the reform proposals of the last few years. But the time-bomb is already ticking: the controversy of new classical liberalism and social-liberal thought in the party of the Free Democrats may challenge some of the scholars to launch research programs in new liberal economics. Those reform economists, however, who joined the parties of the new government coalition in the hope of going further along the Third Way, now without the Communists, may face quite different challenges. They will have to reconcile the concept of "social market economy" (pronouncedly, West Germany is the pattern to follow) with the vision of a future Hungary of smallholders, petty capitalists, and cooperatives, governed by a fairly interventionist state. In other words, their intellectual exercise will be to combine European values of Christian-democracy with populist, nationalist, authoritarian, and anti-Western tendencies that are also integral parts of the world-outlook of the parties of the Christian right of center in Hungary. As far as the prospects for liberalism are concerned, it might be that these experts, unlike the advisors to the social-liberals, will find themselves in the good old closet again.³⁷

36. See SZDSZ, *A rendszerváltás programja*, (Budapest, 1989); SZDSZ, "Gazdasági és szociális választási program," *Beszélő*, March 15, 1990, pp. 2-15; SZDSZ, *Van kiút. A gazdasági fejelmekkedés programja* (Budapest, 1990). See also Laki's paper in this collection.

37. For the economic programs of the smaller parties, see Laki's paper. The warm reception of Iván Székely's Third Way scenario in the intellectual circles of the Hungarian Democratic Forum, reflects the ambiguities in the world-outlook of "national liberalism" in Hungary. Cf. Székely, "A magyar polgárosodás esélyei," *Hírel* 16(1989), pp. 10-14. The apparent lack of Christian liberalism and the recent upswing of national radicalism in Hungary deserve special attention if one wants to understand the rootlessness of liberal thought in the future.

2 Engineering the Transformation Let us leave the field of politics for a moment and suppose optimistically that the liberal imagination of the Hungarian economists will not be constrained by party doctrines. Let us now examine those signals which are being issued by the transition process itself. How will the challenges of the transformation shape the ex-reformers' future research programs? At this point I am about to risk some palm-reading.³⁸

The first reactions of the transformers reflect uncertainty mixed with "cautious pessimism." Nowadays it is difficult to find an economist in Hungary who cannot explain right away why *any* transition program is doomed to fail. The optimistic scenarios (Finlandization, Austrianization, Deutschlandization, etc.) are counterbalanced by nightmare visions such as Balkanization and Lebanonization. Backwardness, crisis, anarchy, dictatorship—this is how the pessimistic scenarios draw the image of the future, whereby future dictatorships need not follow the traditional Soviet pattern (Latin America is one of the frequent analogies). I think that the surviving scepticism of the former reformers indicates certain *similarities between reformation and transformation*.

In the course of the transition, the Hayekian paradox of how to reach, without "constructivist rationalism," a spontaneous order by starting out from an extremely non-spontaneous one cannot be overlooked. The distance to be covered between the point of departure and even the least liberal and most social stage in the process of transition is so great, the real-socialist inheritance is so pressing, and the tasks of transformation are so divergent that the need for some engineering of the processes is difficult to dispute.

The Hungarian transformer of the 1990s has to cope with the simultaneous tasks of stabilizing, restructuring (modernizing), deregulating (marketizing, privatizing), and opening up an economy that is in an acute internal and external crisis, while simultaneously converting the party-state into a *Rechtsstaat* (democratization) and creating social justice. The legacy of the Soviet-type system ranges from the dominance of a poorly equipped, inefficient state sector governed by artificial monopolies, through stagflation, huge foreign debts, falling real wages

38. See Schöpflin's and Streissler's papers in this collection. See also János M. Kovács, "Das Grosse Experiment des Übergangs," *Tramitz* 1(1990). This paper discusses the main dilemmas of economic transition in a more systematic way.

and the dependence on the Comecon, to the surviving pressure groups, the weak middle classes, and the populations' low level of tolerance—to name at random a few of the "heirlooms" which may paralyse the fantasy of the would-be liberals.

Solving one problem can aggravate another (cf. stabilization and unemployment, marketization and inflation). Then there are paradoxical tasks: privatization, in principle, is a precondition both for marketization and democratization, but also helps the old elite survive. Setting the priorities, i.e., sequencing the tasks, is logically uncertain (should one first stabilize the economy or privatize the state sector, or do both simultaneously?), technically complicated (because of the multitude of the alternative solutions and their combinations), and politically explosive. Seeing these dilemmas, the observer cannot suppress the feeling of *déjà vu*. Similarly to the case of the reformers, *experimenting*, or more exactly, experimenting with radical change in complex economic and political systems, will constitute the core of the transformers' métier. In altering these systems, they will also have to decide how to harmonize the transformation measures, and how quickly the transition process should take place. They will also have to take into account the positive and negative interferences of the proposed measures, the resulting acceleration and deceleration of the course of the transformation, and the self-reinforcing or self-cancelling character of certain processes. And these decisions will also not be merely of a technical nature; instead, they will continue to rest on *logical and political compromises* resulting from a new social contract that one hopes will be more permissive than the old ones.

As a consequence, the transformation may also be considered a Grand Experiment. Systemic change was the main objective of earlier reform attempts as well, although they operated under severe constraints. To put it pathetically, transformation is tantamount to post-revolutionary reformation. In formulating his program for the transition, the transformer no longer has to observe the rules that prohibited large-scale privatization and multi-party democracy. In addition, there is more room to maneuver within the "Soviet connection," the West is more benevolent, the old lobbies have lost a part of their strength, the new government is (for a while at least) free of pressure groups and has the voters' trust, etc. Consequently, the transformer can experiment with the ways and means of the transition with incomparably more

freedom than his predecessors ever enjoyed. Let us now disregard the emergence of those constraints which could result from the populist, nationalist, and authoritarian leanings of the new regime, as well as from the rise of new lobbies. Even if transformation proceeds smoothly, the transformer cannot avoid facing the old problem of *simultaneous liberalization and democratization*. Until recently, as a reformer, he believed that his liberalization proposals had failed because there was too little democracy in the party-state. Now he may learn that too much democracy can also block marketization and privatization. After all, the victims of the radical changes cannot be silenced easily any more.³⁹

Like reformation, transformation will also be a trial-and-error process, with the great difference, however, that in this experiment, organic institutions such as market, private ownership, and political democracy may come to the fore. Owing to their historical congruence, these institutions may well ease the dilemmas and reduce the frequency of errors. Compromises mean "halfway houses" again, though these houses lie closer to the imaginary state of *laissez-faire* than the former reformist ones, and in principle, nothing would seem to prevent the transformer from moving them still closer to the ideal.

A transformer may declare himself a disciple of Hayek or Friedman, saying: a) the new classical requirements of liberalism do not apply perfectly to the initial stages of the transformation; b) these requirements rather provide yardsticks to measure the degree of approximation to the final stages; c) overregulation cannot be abolished only "from below" by the market in a spontaneous way; d) the first major moves in deregulation must be strictly controlled by the government (e.g., with the help of monetarist methods and "active privatization"); and e) the state will have to withdraw after the "first push," that is only after the "normal" conditions for the spontaneous market process have already been created by breaking up the monopolies, denationalizing and monetizing the economy, providing legal guarantees for market transactions, etc.⁴⁰

No doubt about it, with the help of this "*delayed libertarianism*" all that meditation about the future of liberal thought in economics in Eastern Europe becomes unnecessary. The idea of having the govern-

39. Cf. János M. Kovács, "Szocialista vagy szociális piacgazdaság?" *Világosság* 1 (1990), pp. 65–72, and Comisso's paper in this collection.

40. See the Klaus-Jeřek paper in this collection.

ment make the first push may appeal to the former reform economists in Hungary, too. They will probably consider the act of postponement a bit utopian, asking: why the state would withdraw voluntarily from managing the transition processes beyond a certain point. Why would the state bureaucracy commit suicide after all the success? The part of the argument, which is based on the uniqueness of deregulating Soviet-type economy, however, will certainly be accepted by the Hungarian transformers without great reservations.⁴¹

For it is not difficult to support the idea of a strong "medium state" with reasonable arguments even if one does not go so far as to long for a populist dictator or an enlightened monarch who should prevent the transformation process from derailing. Obviously, the main point is that a rapid liberalization of the market and private ownership can be counter-productive during the initial stages of the transition. "Invisible hand" favors the strong, and at the outset strength is with the established state monopolies, that is, with the ancien régime. The market needs adequate market agents: marketization and privatization without demonopolization leads to inflation, indebtedness, etc. "Visible hand" may be required to block the preservation of the old elite's privileges by means of "spontaneous privatization." All these would call for engineering activities performed by a rather strong government, even if the post-socialist economy were flourishing. The current general crisis, however, enhances the need for state supervision of the transition process. The first scenarios by Hungarian economists about the initial phases of the transformation already show how prevalent the idea of strong-intermediate state intervention is (cf. Kornai's term "stabilization surgery"). What we see in these programs is probably not a kind of shock treatment. Nonetheless, tight money policies, price controls, income restrictions, structural development plans, regional sanitation programs, new welfare schemes, etc., are important components of these early transformation proposals.⁴²

41. I would nonetheless advise against creating a new mythology of the unprecedented nature of post-socialist transition. Just because valid theoretical institutions tailor-made for the transformation are lacking, and the practical analogies (democratization in Spain, *Wirtschaftswunder* in postwar Germany, privatization in Britain, etc.) are often misleading, we need not call for a new intellectual anarchy in Eastern Europe.

42. See Kornai, *The Road to a Free Economy*; Blue Ribbon Commission, *Hungary in Transformation to Freedom and Prosperity* (Hudson Institute, 1990); Hid Csoport, "Hid a közeli jövőbe," *Közgazdasági Szemle* 37: 4 (1990), pp. 442-59. See also the three-year program of the Hungarian government issued in September 1990 (*A nemzeti megújulási programja*).

State redistribution and regulation today (though to a lesser degree and by finer means than earlier), *Soziale Marktwirtschaft* tomorrow and "regulated deregulation" in-between—this could be the core of the message of present-day Hungarian transformers. I am afraid that this doctrine, whether it is represented by the Christian right of center or the liberals in Hungary, bears more resemblance to left-wing social-democratic views than to modern Christian-democratic or liberal thought in Western Europe.

Postscript

After 1989, trying to make even cautious predictions about Eastern Europe reflects a sort of intellectual masochism. My excuse for doing so is the plain assumption that the economies and economic theories of Soviet-type socialism might exhibit much greater inertia than one-party rule did. In discussing the gloomy prospects for new classical liberalism in Hungarian economic thought, I do not particularly regret the current "social-democratization" of economic concepts in Hungary. If the reader still detects some bitterness in this paper, it is because I expect that transform economics probably will not join Western social-democratic thought at the present state of the latter, now that it has already been considerably softened by liberal arguments. Learning-by-reading might help the transformers avoid a digression to the earlier, more interventionist, versions of the idea of the welfare state. Nevertheless, I do not believe that nowadays the peace and quiet of the libraries could compete with the excitement of the economics (and politics) of the transformation process.

To be sure, it is not my intention to spoil the feast. The pendulum has already begun to swing in the other direction, even if it has not gone very far yet. This is, of course, no "plunge into liberalism," but it may well be easier to move farther from this starting position.⁴³ We are currently witnessing a transformation in reform economics; the econom-

43. The silent accumulation of scholarly knowledge (particularly in mathematical economics) during the past decades may yield good results in the future. The first textbooks of macro- and micro-economics have recently been published; the Hungarian translations of seminal papers by such authors as Friedman and Stigler have already come out of press, and a selection of Hayek's works will soon follow suit; new postgraduate courses in economics and political sciences are mushrooming in Hungary; and the Western universities have also become accessible for the Hungarian students.

ics of the transformation is, however, still in its infancy. Now this new economics in Hungary seems to head (if at all) toward social-liberalism in a pragmatic way. Yet, why should we exclude a further change in the discourse? Why would it be likely for the "medium state" to succeed in finding a justification for itself in controlling the transformation process? Why should we rule out the possibility that the transformers, frustrated by the government's tutelage over the transition process, will first opt for a less social and more liberal variant of social market economy, and then even go beyond the boundaries of this concept?

In the middle of the 1980s, a benevolent observer of the resurgence of new classical liberalism in the West expressed his doubts "whether the association of classical liberal ideas and rhetoric with the free-market conservatism of the late 1970s and early 1980s will contribute to the long-run strength of the classical liberal revival." He added: "The conjunction of free-market conservatism with illiberal policies in the areas of personal and civil liberties, and the likely failure of the inconsistent and partial attempts at restoring free markets to deliver the growth demanded by the democratic public, suggest that the political strength of classical liberalism may prove to be short lived. The intellectual presence of classical liberalism is unlikely to be so evanescent. Its concerns are those of the age—the overexpansion of government, with all the dangers to liberty that it entails, and the control of policy by rival special interests whose machinations defeat the public interest—and in many areas of thought it has produced scholarship of the first order."⁴⁴

In the Eastern Europe of the early 1990s the same observer would probably formulate his concerns and hopes in this way: The long-run strength of the classical liberal revival in Eastern Europe is, of course, a disputable point. The conjunction of free-market conservatism with illiberal policies in the West has to a certain extent discredited new classical liberalism in the eyes of Eastern European thinkers. The likely failure of these conservative policies in the near future might, however, clear the way for a "normal" scholarly reception of the new liberal ideas by the post-socialist transformers.

44. See Gray, *Liberalism*.