

INTRODUCTION

## Introduction to the Kornai 90 Symposium

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### Abstract

This introduction to the Kornai 90 Symposium briefly overviews János Kornai's rich scholarship with the aim of highlighting those features of Kornai's work that are of particular interest to institutional economists. Above all, the introduction browses through some of his main works, such as *Overcentralization*, *Anti-Equilibrium*, and *Economics of Shortage*, with a special emphasis on the soft budget constraint, *The Socialist System*, and Kornai's latest writings on Hungary's U-turn. We invoke the political contexts of these works to suggest their impact on Kornai's diverse questions, changing methods, and the constraint they put on his conclusions as well as on the reception of the research results. In the end, we underline that Kornai was an independent scholar with an interest in a variety of methods and approaches, who nevertheless, or maybe consequently, had a remarkable impact on the thinking of social scientists and practitioners alike. The four papers presented in the symposium are testimonies to the living impact of Kornai's *oeuvre* on institutionalist analysis today.

**Keywords:** János Kornai; Symposium

János Kornai turned 90 years old in 2018.<sup>1</sup> On this occasion, the editors of the *Journal of Institutional Economics*, and Dóra Piroska and Miklós Rosta of Corvinus University of Budapest, put together a symposium of articles to celebrate Kornai's illustrious career. This introduction to the Kornai 90 Symposium aims at highlighting those features of Kornai's rich scholarship that are of particular interest to institutional economists today.

Kornai was born on January 21 in 1928, Budapest, Hungary. His intellectual journey started after the Second World War in Soviet-occupied Hungary. As reflexive sociologists remind us, the institutional and cultural context within which a researcher analyzes her subject of interest deeply influences the type of questions, methods and the conclusions that may be arrived at (Bourdieu and Wacquant, 1992). In oppressive political regimes, this impact might be even more pronounced. In the case of Kornai, the political context of his academic development plays a key part in explaining why he engaged with a broad range of intellectual approaches – from Marxism through the neoclassical mainstream to a system paradigm of his own creation (Laki, 2018). Although his interest in and sensitivity to differences in institutions have been an undercurrent to most of his research, by no means may one link all of Kornai's work to institutional economics.

His early interest in economics was driven by his reading of the works of Marx in post-Second World War Hungary where Soviet rule had just been established. After reading *Das Kapital*, Kornai decided to become an economist (Kornai 2006: 33). He was taken by the logical reasoning of Marx that was at the same time passionate about the analyzed social issues. Kornai learnt from Marx that social outcomes are not the result of individual decisions, but they derive from the social system of which individual actors are part (Kornai, 2006: 33).

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Thus he started his career as a devout Marxist journalist writing for *Szabad Nép*, the daily newspaper of the Hungarian Communist Party. Reporting on the building of the socialist economy in real life was his first course in empirics-based analysis (Kornai 2006: 49). He was relieved of his duties at *Szabad Nép* in 1954 and the next year he took up a job as an economic analyst at the Hungarian Academy of Sciences. After the death of Stalin in 1953 and the subsequent easing of political control, Kornai gradually became acquainted with the actual functioning of the Stalinist regime (Kornai, 2006). His doctoral thesis, *Overcentralization in Economic Administration* (1959, published in 1957 in Hungarian) was an important step in this process, and testifies to how Kornai realized the stark discrepancy between the Marxist–Leninist depiction (and its alternative interpretations) and the empirical reality of the functioning of the economy.

For institutionalists, *Overcentralization* is remarkable for its focus on human behavior and on the relations between institutional incentives and human actions. Its core argument is rooted in an empirical investigation of the internal conflicts and bargaining processes of centrally planned economies (Gedeon, 2013), and points to the negative consequences of centralization from the point of view of its social (rather than its narrowly economic) impact. It takes the form of Kornai’s hallmark research method: the analysis of systemic properties supported by rich empirical evidence.

At the end of this process, Kornai broke with Marxist ideology and although he retained the systemic focus, he decided to ignore the Marxist toolkit for his own research purposes (Kornai, 2006: 78–82). This was a brave step that threatened to isolate him: he decided to ignore Marxism in socialist Hungary, where Marxist political economy had a politically guaranteed monopoly and defined the language, instruments, and ideas of economic research (Laki, 2018).

By the time of the suppression of the Hungarian revolution of 1956 against Soviet rule, Kornai decided that although he would not emigrate to the West like many of his compatriots did, he would work toward the goal of taking part in the intellectual community of Western economists (Kornai, 2006: 123). He also realized how important mathematical and model-based reasoning is for this community (Kornai, 2006: 135). Therefore, around 1957–1958, Kornai significantly redefined his interest in economic research and turned to formal mathematical reasoning (Laki, 2018). The language of mathematics not only permitted a non-Marxist approach to the study of the economy, but it also gave him a form of security from the political censors. The use of mathematics established the impression of political neutrality while creating the desired link to Western academia, where economists were eager to get to know someone from the other side of the Iron Curtain. For example, it was Hicks who recommended the publication of *Overcentralization* by Oxford University Press in 1959. The Kornai–Lipták theory on two-level planning tackled some of the problems Western mathematical economists struggled with, and therefore received great interest in Western academic circles. As a result, by the 1970s Kornai became an established researcher both in East and West.

The 1971 publication of *Anti-Equilibrium* and the research leading to it, defined another turn in Kornai’s intellectual journey. His interest in the General Equilibrium Theory (GET) of Arrow and Debreu was driven by two related puzzling features of GET. On the one hand, Kornai, uniquely among economists, became interested in the epistemology of economic research, asking the fundamental question “How exactly do we move from deductive models, whether choice or game-theoretic, to empirical work?” (Haggard, 2018: 12). He devoted a substantial part of *Anti-Equilibrium* to investigating the extent to which GET, or any other theory, can be empirically verified – a fundamental question that has no equivocally accepted solution in economics even today. Nevertheless, precisely for asking this question, *Anti-Equilibrium* features as a key text in philosophical explorations on the origins of economic thought (Hausman, 1994; Hodgson, 1993; Kaul, 2007).

On the other hand, and from an institutional economist’s point of view, *Anti-Equilibrium*’s core argument is even more important: it critically examines a long list of assumptions that must be satisfied for the Arrow–Debreu model to hold. Many of these assumptions have since been refined and relaxed by economists. However, as Haggard (2018) pointed out, Kornai’s critique of the model centers on a lack of adequate attention to the role of institutions. In fact, Haggard (2018) continues, in his attempt to provide an alternative to GET, Kornai sets up his own analytical tools based

on his understanding of the “system.” For Kornai the system is based on “the *institutions*, the *organizations* within the individual institutions, and the *units* within the individual organizations” (37, original emphasis). Kornai misses from GET the same lack of attention to the actual functioning of the economy that he earlier missed from Marxist analysis (Kornai, 2006: 179). Gedeon (2013: 4) also stresses Kornai’s focus on the lack of attention by GET to institutions: “*Anti-Equilibrium* was an attempt at bringing together analytical theory with the theory of real economies, an attempt at enriching general economic theory with the theory of social institutions.”

A few years later, to grasp at the micro-level economic processes that he deemed inadequately treated by GET, Kornai turned to further mathematical modelling in 1973 (Kornai, 1973). In the following years, although *Anti-Equilibrium* received some harsh criticism (most notably from Hahn (1973)), these institutionalist units of analysis, and the interactions by which they form a system, came to be at the core of Kornai’s interest (Móczár, 2017). This is why Vahabi (2018) argues that *Anti-Equilibrium* foreshadows Kornai’s later works that are formulated with the system paradigm.

In 1980, Kornai published *Economics of Shortage*, which returns in a way to his earlier interest in the analysis of the socialist economy: a synthesis of his thoughts on the dysfunctionality of the socialist system. Interestingly, the book was very differently received in the East than in the West. As Kornai recalls in the Blanchard interview (Blanchard, 1999: 439), for Eastern intellectuals the book’s major message was that the problem with socialism is systemic and that it cannot be reformed, as many other Eastern economists suggested at the time:

An East European or Russian or Chinese reader of the *Economics of Shortage* did not consider the theory of the soft budget constraint the main contribution at the time. For him or her the principal message of the book was this: The dysfunctional properties of socialism are systemic. I want to emphasize this appraisal in our conversation, because conveying this message I was rather isolated from the rest of the so-called reformers who were working on small changes to the Communist system. In that sense, it’s a revolutionary book, because the conclusion is that cosmetic changes and superficial reforms do not help. You have to change the system as a whole to get rid of the dysfunctional properties. That is the book’s main contribution, and I think it had a great impact: The message got through.

In other words, the political context within which Kornai’s work was published had a major impact upon the reception of his writings. In the East, it was read as a political manifesto about the deficiency of socialism. In the West, researchers mainly found the concept of the soft budget constraint remarkable.

More precisely, in the West, economists were primarily interested in Kornai’s explanation of the specific causes of shortages, which he attributed to soft budget constraints (SBC), i.e. “the ability of state enterprises to replenish their liquid financial resources through budget subsidies or credit (by banks and/or suppliers) whenever money prices were raised in order to reduce shortages” (Nuti, 2018: 86). Clearly, the SBC is related to a number of concepts such as time inconsistency, moral hazard, and rent seeking. However, unlike these other concepts, the reason why the SBC leads to richer economic analysis is that the concept’s explanatory power hinges upon the actual institutional context within which it is applied. Hence, the researcher is forced to explore this context. Gedeon (2013) pointed out that in Kornai’s own application of the concept within the institutional specificity of the socialist system, the softness of the enterprises’ budget derives from the nature of bureaucratic coordination and state ownership. As such Kornai’s explanation for the existence of SBC is based on both an analytical and an empirical component, or in other words a universal and a historically specific aspect of the economy (Gedeon, 2013). As Csaba (2017) argues, the SBC represents a valuable example for the overlap of neoclassical economics on the one hand, and comparative and institutional economics on the other. Due to the universal component of the concept, the SBC syndrome is by no means confined to the socialist system. On the contrary, it exerts itself with varying force in several areas of the capitalist system as well (Kornai, 2014: 39).

Socialism collapsed in the early 1990s, giving way to a period of transition in Eastern Europe. It was not only the social context within which Kornai worked that changed dramatically over a short period of time, but since he was a researcher of socialism, his subject matter all but disappeared. By that time Kornai had transferred to Harvard, where he became part of an intellectual community very different from his home institution at the Hungarian Academy of Sciences. Institutional economists led by Douglas North, Ronald Coase, Oliver Williamson and others had started organizing their sub-discipline; Kornai observed this but never truly took part in it. Kornai's work on *The Socialist System* was bound to reflect upon all these changes.

*The Socialist System: The Political Economy of Communism* was published in 1992. *The Socialist System* is an important contribution to comparative and institutional economics as well as to political economy. Building on Kornai's analytical invention, the system paradigm, the book establishes an ideal-typical theoretical model of the socialist system and provides rich empirical analysis of a few selected countries (Haggard, 2018). The book is organized into three parts. The first part provides a general introduction to Kornai's method of analysis, the system paradigm. It defines the elements that he deems persistent features of any system (not only socialism): (1) the effects of political institutions on the economy; (2) how social factors influence decision-makers; and (3) how principal-agent relationships influence decisions and economic performance (Kornai, 1992: 12). In the second part of the book, Kornai goes on to give a detailed empirical analysis of the classical form of socialism as it developed in the Soviet Union and in China, and later emerged in Eastern Europe and in several Asian, African, and Latin American countries.

For institutionalist scholars, Kornai's way of building up the ideal type of the classical socialist system is remarkable. As Haggard (2018: 15) argues: "Kornai is quite explicit that the economic features of the system derive immediately and in the first instance from the system's political structure, which he defines to include both its institutional arrangements and ideology." In other words, for Kornai the classical socialist system is not defined by the domination of state ownership over private ownership of the economy; rather, state ownership is a derivative of the political structure within which the monopoly of the communist party and its Marxist-Leninist ideology predominates. Kornai adds this novelty to the analysis of the socialist system that he could not quite articulated in the *Economics of Shortage* 12 years earlier, when socialism and one-party monopoly of political power were still at its height in Hungary. Throughout the analysis, Kornai develops his own vocabulary and analytical tools in order to understand the classical socialist system and to extract the essence of its functioning.

In the third part of *The Socialist System*, Kornai turns to analyzing the reform processes of socialist systems such as the ones advanced in Yugoslavia or Hungary from 1968 onward. In this part, he takes on issues such as political liberalization and the rise of private property. His conclusion – resonating with the findings of *Economics of Shortage* – is that because the socialist system is built around the political monopoly of the communist party, reform is futile as long as this monopoly is not broken. However, once this monopoly is broken, Kornai expects a natural turn to a market economy and a substantial increase in the efficiency of economic production.

Kornai's writings have had important political consequences not only in Eastern Europe, where his works clearly inspired liberal market transformations in the early 1990s, but also in China. In 1985, Kornai was one of the seven Western economists who were invited to participate in the Basha boat cruise on the Yangtze River together with leading Chinese economists to discuss the possible course of the economic opening of China. "Kornai concluded his presentation by declaring that the IIB model of market coordination with macroeconomic control was the only sensible choice as the target model for China's reform" (Gewirtz, 2017: 144): a conclusion that resonated well with Chinese economists' own understandings. As Gewirtz in *Unlikely Partners* (2017) demonstrates, Kornai's writings, especially *Economics of Shortage* (over 100,000 copies were sold in Chinese translation), had a profound impact on the thinking of Chinese reformers, including Wu Jinglian, one of the most influential reform economists, and represented the basis upon which Deng Xiaoping's economic opening policy was formed. Kornai's impact on Chinese reforms has been further enhanced through the influence of

his PhD students from Harvard, who are today among the leading thinkers of China: Chenggang Xu and Yingyi Qian both received the highest economics prize of China in 2016 (the China Economics Prize).

From an institutionalist point of view, it is important to highlight that Kornai's reform suggestions were somewhat different in Eastern Europe than in China. Reflecting on the distinctively different institutional setups of the two societies, in China he suggested market liberalization with politically retained macroeconomic control, while in Eastern Europe he advocated quick liberalization and the political locking-in of market reforms. In 1989, Kornai published "A Passionate Pamphlet in the Cause of Hungarian Economic Transition" in Hungarian (targeted at Hungarian reformers), which was a blueprint for the economic transformation that was to accompany the political regime change, complete with the list of the inevitable elements of the new system in the making. With this publication, Kornai broke with his former compromise of avoiding interference with economic policy debates. This was made possible, of course, by the radical transformation of the regime, the political context of his work.

In the 1990s, Kornai was not only an influential advocate of fast market reforms, but also a remarkable analyst of the transition process. One of his main analytical contributions was the definition of the "transformational recession," which he published in 1994 (Kornai, 1994). With this term, Kornai referred to the recession that inevitably hit all transitioning post-socialist societies resulting from the collapse of former economic institutions. In this article, the capitalist ideal system is depicted in a rather non-institutionalist way, whereas the transitioning economies are differentiated according to the functioning (or not) of various institutions. In the early 1990s, Kornai's treatment of "capitalism" or "market economy" as an institutionally non-differentiated economic system was the norm of mainstream Western economists.

In 1992, Kornai became a permanent fellow of Collegium Budapest, Institute of Advanced Studies, which gave him the opportunity to do more research in transitioning Hungary. Aware of the social problems and resentment that followed the transitional recession, Kornai turned to the analysis of the reform of social institutions, for example in the paper "Choice and Solidarity: The Health Sector in Eastern Europe and Proposals for Reform" (Kornai and Eggleston, 2001) and the volume *Reforming the State: Fiscal and Welfare Reform in Post-Socialist Countries* (Kornai et al., 2001). Moreover, with these publications he contributed importantly to the institutional analysis of the healthcare sector.

Kornai furthered our understanding of the capitalist system as well. In his essay titled "Shortage Economy – Surplus Economy" (published in 2013) Kornai analyzes the functioning of the capitalist system (Kornai, 2013). According to Chavance (2015), one of Kornai's main arguments in this essay is that the production of surplus and unemployment is an essential component of capitalism (Chavance, 2015: 46). Kornai invokes a number of different institutional themes to corroborate this finding. However, Kornai not only describes the systemic properties of capitalism that creates surplus, but also analyzes institutional contexts within which shortages might appear (e.g. the healthcare sector) or institutions within which the hard budget constraints might soften, giving place to softer budgetary conditions (e.g. financial markets).

Kornai's latest writings are provoked by the ongoing political changes in Hungary, where he relocated after his retirement from Harvard in 2002. Once again in his long and productive life, the political context changed. In 2015, "Hungary's U-Turn" was published (Kornai, 2015). This article was in response to those commentators on Hungary's political change of direction under Viktor Orbán, who did not see, or did not admit clearly, that the Hungarian political economy is driven by authoritarian tendencies. In this article, Kornai recalls his earliest research on the over-centralization of the Hungarian socialist economy and demonstrates, point by point, how under Orbán, the Hungarian state institutions and the economy are returning to a centrally controlled and authoritarian state. Fueled by the findings of his research, Kornai, in his closing remarks at the "Kornai 90" conference organized at the Corvinus University of Budapest, underlines the importance of values in economic research:

[E]ven if you are working in other fields of economic analysis, at least in your way of thinking don't become apolitical. At least in the back of our minds, all of us should be political economists. And in that capacity, it is our never-ending task to think about the complex dilemmas of choosing fundamental values. (Kornai, 2018)

In 2006, *By Force of Thought* appeared: a memoir in which Kornai takes account of his intellectual journey. Kornai provides important insights into the intellectual struggles of his early years that he could not make public during the oppressive socialist regime (Kornai, 2006). He also traces his relation to Western and Eastern economists, and arrives at the conclusion that he has never really been part of a school within economics and that it has never really been his intention.

Therefore, while in this introduction we want to point out the many ways in which institutionalist scholars today may draw on the rich analytical toolkit and empirical methods of Kornai for their own research, we do not want to suggest that Kornai is an exemplary institutionalist himself. As this overview testifies, Kornai started as a Marxist, turned to mathematical modeling later, and wrote the most detailed study of the classical socialist system based on a system paradigm. In other words, Kornai contributed and was influenced by a large number of traditions in economics. In fact, János Kornai created an example of how to be an independent scholar and nevertheless have an important impact on the thinking of others.

The contributions to this special issue cover a range of topics related to Kornai's work.

Imre Fertő, Štefan Bojnec, József Fogarasi, and Ants Hannes Viira (2019) investigate farm investment behavior and the presence of SBC in the agricultural sectors of three Central and Eastern European countries – Estonia, Hungary, and Slovenia – using individual farm accountancy panel data for the 2007–2015 period. Their findings indicate that gross farm investment is positively associated with gross farm investment from the previous year, growth in real sales, and public investment subsidies. They argue that a particularly significant negative cash flow coefficient is the result of the SBC faced by Estonian farms, while the insignificant cash flow coefficients imply harder (less soft) budget constraints for Hungarian and Slovenian farms.

Yang Zhou (2018) analyzes horizontal bargaining within every political branch in contemporary China while building on Kornai's work on the socialist system. The author argues that horizontal bargaining within the party is enhanced by vertical bargaining. Incorporating Kornai's work on socialism, the "party chief and mayor" template extends the bargaining model from one key figure and one group (as in the "king and council" template) to two key figures and their respective confidants. In addition, it incorporates institutional constraints into the graphical model. It also defines a "collective decision probability function," which shows how the party chief and mayor model reaches "checks and balances" that limit the policy space, regardless of whether the policy is exogenous or endogenous.

Áron Perényi, Alexis Esposto, and Jill Bamforth (2019) build on Kornai's transition model and development studies to construct and apply a model of transformation for Latin America. The authors' aim is to better explain the relationship between institutional transformation and developmental outcomes over time. The analysis exploits historical information and the views of current political leaders in Argentina. The analysis reflects on institutional performance and evaluates the applicability of the proposed Latin American transition framework. Based on the empirical evidence presented, the authors argue that their model of the interaction between economic and political changes provides an explanation for institutional transformation in Argentina.

Zoltán Ádám (2019) conceptualizes authoritarian populism in terms of political transaction costs, arguing that its primary function is to integrate political exchange vertically under conditions of general franchise. Ádám argues that if successful, authoritarian populist regimes internalize a large share of political transaction costs inherent in decentralized democratic political exchange. This entails a degraded version of democracy, eliminating a significant part of substantial electoral choice. Through weakening impersonal collective political contracting, authoritarian populists bring back private political contracting as a dominant political coordination mechanism, effectively re-feudalizing democracy.

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