

## ECONOMIC SYSTEMS: CONSTRAINTS AND DRIVING FORCES OF CHANGE

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ABSTRACT: This essay attempts to present an overview of driving forces and limitations of changes in economic systems. We put it in the context of the ongoing global debate over major issues of economic theory. The rich experience of the 20th and 21st century has provided analysts with new insights and generalizations for comparative economics. In the following we offer six of the potentially less controversial, if not uncontested, results of global research in a theses-like fashion. These, we hope, may be relevant both for general economics, and particularly for its much needed improvements over the current, over-standardized education, The observation of a variety of transitions, and its policy applications helps creating a more relevant brand of science, both for understanding and improving reality, a research project that students of post-communist economies are naturally pre-occupied with.

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'*Das Neue ist die gut vergessene Alte*' – the old is mostly not more than the well forgotten old, says the German proverb. Indeed, economics of the post-second world war period tended to be ahistoric, not caring even about its own traditions and venerated history. It all started with the breakthrough of formalism in the 50s and 60s. Already four decades ago Axel Leijonhufvold/1973/, one of the major figures reviving and interpreting Keynesianism joked about true economists' being the only tribe where not even high priests cultivate the myth of their own past glory. In the past quarter of a century this situation has only been aggravated by the deep disrespect for history, contextuality and applications. As the intro to a recent special issue of the *Cambridge Journal of Economics* rightly observed/Freeman et al., 2014/ – and other contributors only expanded – the

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mainstream of the profession has been carried away by Samuelson's perceptions about the proper conduct of economic science.

In this interpretation – which is by now under heavy attack- the current state of art is always its best. Axiomatically it is the peak of previous knowledge, written by the victors of intellectual debates. By now, seeing the dismal performance of neoclassical mainstream theories, both as analytical tools of understanding, and even more as useful instruments for improving social practice, the contempt for practice, the public and professional perceptions have changed. For the majority, the Samuelsonian maxim is that coherence tests may and indeed, should replace testing the ground, i.e reality check. But this / still widespread / practice has been discredited for an ever growing crowd of theorists and policy-makers, business executives and curious intellectuals, coming from other professions alike.

Related to these voices we may add a recent study of Ph.D programs of top American universities. The latter have been shown – via a detailed analysis of their empirical results – to be rather weak at producing good quality researchers and research, as measured by their own standard, i.e AER<sup>2</sup> level journal publications and equivalent/Conley and Onder, 2014/. This is clear evidence of the failure of those practices, which are portrayed as exemplary, and the only way to followed by catching up societies the world around.

As a consequence in most European and American universities the imperialism of the neoclassical mainstream prevailed, leading to – inter alia – to the closing down of established comparative economics departments in many leading universities, and similarly oriented area studies centers outside of them. This has hardly been justified in most of the cases. The United States, as the lonely hegemon, is increasingly being confronted – and not only in the past few years – by a variety of challenges coming from other civilizations and other economic regimes, supportive of dictatorial or autocratic regimes. Failing states have allowed for the creation terrorist organizations, which in turn allowed for the spread of a variety of criminal activities unknown of in a few decades ago. The double challenge – economic and security – would have called for an expansion, rather than the

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<sup>2</sup> American Economic Review. Note, that the no 1 journal in official/IDEAS etc rankings is not the flagship of the American Economic Association, but the *Quarterly Journal of Economics* of Harvard University.

actual divestiture of those centres of comparative and area studies – a trend observable ever since the first Clinton Administration.

Similarly in Europe the idea that „we are back on track”, and a false feeling of „end of history” created similar trends. Centers for comparative and area studies have been closed down or marginalized in all countries, under two slogans. Number one was the alleged new age of ‘eternal peace’, where the so-called frozen conflicts, let alone open warfare, as experienced ever since the Lybian and Syrian uprisings, or the armed intervention of Russia in Georgia and later in Ukraine – were deemed highly improbable. Thus funding for ‘estoteric’, non-mainstream economic activities dwindled<sup>3</sup>.

Second, not less importantly, the more widespread the idea become, that economics is like medicine, where established general insights rule over country-specific or simply contextual knowledge, the farther standardization may and does go. This have turned economics and business teaching, from BA to PhD levels, into factories of transmitting standardized, vulgarized and modularized American mainstream insights, themselves strongly contrsted in the literature. Certainly massive increases in student numbers also contributed to this end. But the unfounded capitalist triumphalism- suggesting ‘normal economics for normal countries’<sup>4</sup> - also had its share in shaping the outcomes.

Therefore it is hardly surprising, that with the advent of global challenges the inadequacy of those options has become manifest, for the supply and demand side alike. Top ‘pure econ’ classes fight for survival in many univerities, not least because of lack of student interest, both at the MA and Ph.D levels. In buisness and state administration, ie on the demand side, jobs previously filled by econ graduates are being filled with persons with different degrees, be those in maths, physics, law or political science. *The time for change has come* and one area, where heterodox economics has something of immediate use to offer, is precisely

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<sup>3</sup> Two telling examples from Germany are the severe cutback of the Institute for East European Studies at the Free University of Berlin to about a fifth of its original staff and merging it into the faculty. The second case is the chastizing of the traditionally prestigious Institute of East European Studies from the Bavarian metropolis of Munich into parochial and distant Regensburg, wheer it leads a shadow life, attached to a regional – not top research – university.

<sup>4</sup> The ‘most cited economist of the globe’/according to wikipedia entry and IDEAS, both retrieved on 11 Oct, 2014/, unfamous for his role in managing shadowy deals in Russian privatization, Andrei Shleifer/2005/ has gone perhaps the farthest advocating this line. This happend in face of mounting evidence to the contrary, already at the onset of the first Putin Presidency. On the latter cf /Bugajski and Michalewski, eds, 2002; Rosefielde, 2005/.

in *reviving the comparative-institutionalist approach*. The latter has always been a key ingredient in the study of economic systems<sup>5</sup>. Thus our proposals may serve both a re-assessment of what counts as academic excellence – in terms of promotions and useful knowledge – as well as to improving the curricula, making those more responsive to the needs of employers. The fundamental claim in this paper is that there are at least six – and potentially much more – issue areas, where *comparative economics might be a useful tool for improving both research and education at the university level across the globe*. These insights count among the least controversial from within the subfield, still these may sound indeed revolutionary or path-breaking for the standardized uniform curricula and those delivering/studying those.

1. Crisis on the global financial markets and in European Union alike have repeatedly called for a *complex approach* to economic and social issues. It borders with the platitude to claim, that the reign of unintended consequences, typical of policy interventions, must be attributed to the lack of comprehensiveness of treatment. Needless to say, comparative static was overused in the Samuelsonian economics. Likewise treating economics as a sheer methodology of calculating anything, rather than a proper social science, had a role in allowing for the very narrow and overly technocratic approaches. This holds not only for IMF or troika type of interventions, but also to the usual incrementalist views on how to improve taxation, how to balance the budget, or how to improve higher education. The 'new' policy is a comprehensive, *systemic approach*, which used to count among the axioms in comparative economic systems' research. This approach originates with the German economist Walter Eucken/1940/1989/ criticizing interwar and wartime Soviet and Nazi policies of ad-hoc interventionism and replacing incentives with brute force/oppression. In so doing he developed the concept of *Ordnung und Ordnungspolitik*. These terms lend hardly themselves to a proper translation, but imply two major insights, which are relevant today<sup>6</sup>.

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<sup>5</sup> János Kornai has been an iconic figure of this approach, ever since the publication of his first book nearly six decades ago, in 1957. It was the first ever book published in English from anyone working in Hungary in the postwar period in 1959, reprinted in 1994/Kornai, 1959/.

<sup>6</sup> The ex post analytical framework, developed in /Kornai,2008/ lends empirical as well as theoretical support to sustain the unchanged – or even heightened – superiority of systemic thinking over the currently ruling narrow approaches, both in theory and in applications.

a/ The economy works as a system, more like a living organism than an engine postulated by Walras and others. Thus an intervention at one point inevitably triggers changes in a whole different areas. Much of those interactions can be studied and incorporated into a – largely restrained – set of policy measures, which should never aim at defining, which horse is to win the race.

b/ Policy interventions should be exceptional, general, and relating to the overall fabric of the economy, or the business cycle in particular, but not to micro-managing sectoral, regional, or other particular grievances. It seems, that heeding those insights could have saved many ills of the crisis management in Europe/Csaba, 2009/.

2. Economic systems are liable to change if they are to survive, like any other living biological or social structure. The past century saw a series of transitions in this sense: from *laissez faire* to managed economy, from Keynesianism to a kind of rules-based orthodoxy, from market to plan and vice versa, and more recently from untamed globalization to managed transnationalization of global exchanges. Observing the variety of changes, both in terms of circumstances and outcomes, and allowing for the varying experiences of the interrelationships of those changes with political democratization, we would tend to agree with those analysts who foresee a lasting diversity of experiences, efficient methods and outcomes/most explicitly and lastingly: Rodrik, 2007/. No compelling evidence – over and above our own value judgements – brings us to expect that democracy and market economy will always go hand in hand, or if the victory of these 'inclusive institutions' would be in any way a historical necessity, either in terms of time or especially in any concrete regime change. The most recent experiences in Ukraine, Libya or Venezuela indicate, that a change which may start as a corrective, at the end of the day, culminates into decay and disintegration. Perhaps economists should bet less on the predictive power of their arsenal, once singled out by Milton Friedman/1953/ among the preconditions of academic soundness. Perhaps we should listen more to the ruling skeptical voices in historiography, in sociology and political science, where no outcome seems to be a given, not even in the constructivist and post-modernist approaches. Also, the more we take the system paradigm seriously, the more one would need to accept insights

from complex systems' theory/and even chaos theory/. Both would caution us from making direct policy-relevant or even predictive inferences from simple, or more complexly constructed, econometric models based on the replica of 19th century physics. These are postulating linear or uni-dimensional causation, predictable paths and/or outcomes. Russian economic system nowadays, in any account, is a far cry from Soviet-type planning, and the decisive co-ordinative mechanism is undoubtedly the market. Still, it sounds naive and premature to assert – as it happened a decade ago – that Russia would be 'a normal country'/ Shleifer, 2005/ in the western sense, or that its model would not differ, in terms of comparative economics, from those in EU economies. Hopes for its convergence, vividly entertained by many of us in the 1990s, have clearly evaporated in any account of events<sup>7</sup>.

3. Comparative economics has a great advantage over the neoclassics in terms of its ability to *endogenize technological change* and its broader concept, innovations. The major trick/more recently in: Kornai, 2013/is twofold.

a/ In comparative economics *incentives are endogenous*, a part of the classical description of what is entrepreneurship all about;<sup>8</sup> b/ In employing *institutions*, explaining how the idea is turned into economic – and more importantly also to social - use, *or how knowledge is used in society*<sup>9</sup>.

While those insights count among the axiomatic propositions in comparative economics, the technocratization of the mainstream has fully crowded out

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<sup>7</sup> It is indeed ironic to read during the Ukrainian- Russian border war, the oppression of the Belorussian dissident movements, the recurring harassment of opposition in central Asia to the point of repeated torture and imprisonment without jail, the lifelong Presidency of Kazakhstan and many others, that leading American scholars deem these as parts of their perceived 'normalcy' even at the time of writing/Shleifer and Treisman, 2014/.

<sup>8</sup> It is telling, that the flagship of the American Economic Association, targeted to the broader audience, *Journal of Economic Perspectives*, vol.28.no.3/2014/ devoted a special symposium with three long articles explaining the relevance of the Schumpeterian insight to contemporary economics, both theory and real world.

<sup>9</sup> It is no less telling – and sign of changing times – that the long forgotten seminal paper of Friedrich August von Hayek/1945/, himself marginalized and ridiculed most of his lifetime by the neoclassicals, has been included among the 20 most influential papers ever published in the *American Economic Review*, in its retrospective selection of vol.101.no.1./2011/,pp1-8.

such insights from both academic discourse and the curricula. Such broad approaches constitute a U-turn against the Samuelsonian view of treating economics as a value-free analytical instrument, or of the practice of Gary Becker, often termed as 'economic imperialism' (Lazear, 2000), which attempts to create *micro-foundations for everything*. Moreover it attempts to explain literally everything – from marriage to discrimination – along those lines and following the logic of the micro.<sup>10</sup> By the same token reliance on sociological insights, on industrial organization or even on empirical psychology becomes a must. This is, in turn, severely *limits the conventional freedom of economic modelling to employ assumptions not justified by anything/or being positively dispelled by the sister disciplines/*. One of such ideas is rational expectations, the other being the symmetry of loss and gain in terms of elementary calculations.

4. One of the eldest and most contested issues in comparative economics has been that of development traps or the lack of those. Economics as a discipline and development economics as its sub-discipline has always been concerned of 'why some countries are rich and others so poor' (Landes, 1998). These issues can not be answered in a generalized fashion, as we indicated above. In a modern, formalized, neoclassical economics environment this would not even count as an economic question. True, answering those weighty – and evergreen – issues does require reliance on the sister disciplines, history, geography, public administration, psychology, sociology and international studies.

It is indeed reassuring to observe, that in the flagship of the mainstream, after a long hiatus, we do find again extensive and deep analysis of this issue (Kraay – McKenzie, 2014). Not that the issue per se would not be relevant, but – following the external shock of the crisis and the sustaining dissatisfaction with the neoclassicals – we do find the return of this age old subject to the sanctuary of economics. The broad analysis cited above is an excellent case in point, illustrating how the *revival of the comparative and institutional approach may be indispensable* if weighty and policy relevant

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<sup>10</sup> The requirement to provide micro-foundations to any claim is, of course, much more widespread than indicated in the main body of the text, although one would consider as axiomatic the age-old insight that any structure – of the macro – is by definition more than the simple sum of its constituents. Therefore psychology can not be reduced to biology, the latter to chemistry, the latter to physics, as the 19th century thinking would have liked it.

subjects are to be analyzed. The nuanced analysis cautions against the 'usual suspects' in development economics, such as the 'big push', i.e. opting for extremely high investment rates, or the focus on external aid and micro-finance.

What comparative economics may add to those – highly welcome – new insights is its traditional focus on the *competition among economic systems*. This exists both on the micro level – across firms and individuals – as well as on the macro level, across various institutional solutions, country-specific options. This focus follows from an age-old and sustaining observation of most of us constantly measuring our well being 'against the Jones'. As indicated more recently by the collapse of the Soviet Empire, but also by the recurring strains in Hong Kong versus mainland China, that differing output/performance does translate into collective political action in the long run. Certainly, we may only speculate, and make more or less informed guesses about *if and when a leadership is willing to opt for change*, rather than resort to violence or simple procrastination, wishing to put out the fire on time.<sup>11</sup>

5. Perhaps one of the more intriguing insights which may and does come from comparative economic studies is the relevance of *path dependence and path creation*, one of the reasons for sustaining the field across the ups and downs of political and professional fashions. If we analyze – as it is anything but customary in the myopic approaches of the mainstream – developments *à la longue durée*, the relevance of those insights become evident. Let us think about such cases as of Spain and Italy, when long-standing traditional weaknesses – in terms of public finance, in terms of structures and competitiveness – seem to have been addressed by and for EMU entry. In both cases history seem to have mattered more than policies, though one may always blame politicians for not being tough enough. And conversely, if one considers the relative success stories, like Slovakia, Estonia, Turkey, or India, it is clearly possible to see a chance for

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<sup>11</sup> The bloody crackdown on the Tienanmen Square in June, 1989 served as a wake-up call for those advocating 'inevitable' liberalization scenarios in China. On the contrary, Germany could fundamentally reform its labor markets and come out of the doldrums of the late 1990s, though the odds for this were quite bad.

moving out of the vicious circles of historic determinism. It remains, of course, *something of a mystery, when and which element dominates*. Thus it is always a most intriguing task for the theorist, economic, sociologist or historian, to figure out the chains of causation and limits/possibilities of generalizations. What seems to be an uncontested point for us that history matters, although it is not quite clear when and how, and what way we may operationalize this insight for individual cases. Alas, traditional case studies are also back in vogue, also in more mainstream journals as well, if we take *Journal of Development Economics* or even *American Economic Review* as a standard of evaluation.

6. Finally one may want to *bring back the political* in meaningful economic analyses, especially at the macro level. Traditionally, macro was understood and even officially termed as Political Economy, and many Nobel winners, from Phelps to Mirlees occupy even today professorial positions in political economy.

Once we overcome the quantity fetish of the 50s, 60s and 70s, and accept the economy being a complex system, run by free –or less free – individuals, the need for the political re-emerges.

Let us note: the political is not the same as references to public choice. In most of the cases it is impossible to define both the „public” and the conscious „choice” element in the actual processes, be those macro or micro level options.

Involving the political means respect for individual and group preferences as well as for the democratic process of aggregating those. As we know already from the classic piece of Kenneth Arrow/1950/ there is no such thing as a social welfare function, which could either be postulated or aggregated from the micro-level preferences. Thus the respect for the process of selection, the need for reliable information to make informed choices, the institutional support for public good are all vital for meaningful, efficient and feasible economic decisions to be taken.

Once we appreciate democracy as a major precondition for informed economic choices, the horizon of economic analyses must open up considerably. In line with already ongoing experimental economics and behavioral economics research programs, one needs to appreciate the significant impact of seemingly non-rational – and thus traditionally neglected – items as perceptions, as expectations, herd behavior, the impact of discourses/which can not be centrally shaped/, strategic behavior and non-cooperative games, and losses of information, even disinformation all being parts of the power game. Power hungry political agents are then not extremes and mere distortive factors to economic rationality, but integral part of the analytical frame.

Having gone so far calls for the re-habilitation of such aged concepts as solidity, personal integrity, calculability, honesty, commitment to the public good. Good governance as understood by the World Bank – and by a broad body of management literature – is a basically *qualitative concept, not liable to quantification*.<sup>12</sup>

If quality is back on the agenda, it is perhaps not heretic any longer to profess one's preferences, stated in an explicit fashion. Others may or may not share those, but at least the line of the argument becomes clear.

Even with this more sophisticated arsenal of economic analysis, we may not have a *Wunderwaffe* at hand. The collapse of Communism in the Soviet Empire and its gradual, but visible demise in countries still under the rule of Communists, as Vietnam or Cuba, have shown the limits of how far centrally managed systems can go. But similarly: quarter of a century of experience with market economy and democracy reminds us: this option may, and indeed, does have its ugly face as well. We are not free to cherry pick the good items from each at will, as János Kornai/2013/ reminds us in his skeptical notes. But the room for improvement is indeed there.

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<sup>12</sup> It is ironic to see the widespread use of composite indices for assessing what is basically a qualitative, intuitive item. Love can not, and perhaps also should not, be measured by the amount of gifts we exchange, not even with the time we spend together.

What we conclude from this sketchy *tour d'horizon* over the state of comparative economic studies, is *the room for reformist steps*. While these will be a long way from the dreams of social prophets, as well as from expectations of many ordinary people/voters, these improvements, could civilize the unbridled market. These would induce the social into the market economy. More precisely: subjugating the economic to the social, as envisioned by the German founding fathers of the social market economy, Röpke, Eucken, Böhm and Erhard – should be theoretically feasible. However, it remains a topical task to be managed over the coming decades in Europe.

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