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P Economic Systems

From Socialism to Capitalism: Eight Essays. By János Kornai. Budapest and New York: Central European University Press, 2008. Pp. xvi, 240. \$35.00. ISBN 978–963–9776–16–6.

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This book is a compilation of eight previously published "studies," as the author refers to them, and a preface written for the volume. Why should anyone wish to acquire a collection of previously published works? From a practical perspective, the studies have been published in widely disparate venues, ranging from the easily accessible *Journal of Economic Perspectives* to the inaccessible-to-most article in Hungarian only; hence, having these studies grouped together makes for a handy reference volume. More interestingly, János Kornai has created an autobiographical, yet critical, history of his own economic thought as it evolved over the last two decades. His selection criterion for inclusion is the connections between economic and political systems with the resulting impetus for, and process of, changing the system as exemplified by the recent great transformation from socialism to capitalism. The studies are somewhat Hungary-centric with regard to citations and personal examples; however, I find this to be a strength not a weakness of the book. The reader is exposed to important contributions by Hungarians to the history of economic thought;

in addition, valuable insights into policy issues in the transition economies are gleaned from the experiences of someone who lived through system change twice. Most importantly, with some minor editing to render the studies self-contained and liberal cross-referencing, Kornai produces a book that restores systems to its pride of place in comparative economics and provides a solid intellectual foundation for interpreting the last twenty years of the great transformation.

Kornai arranges the studies not in chronological order by date of publication but rather "historically" to follow the road from socialism to capitalism. The first study is an excerpt from Kornai (1992) chosen to illustrate the coherence of the classical socialist system. This theme of institutional equilibrium is pursued in the next two studies by arguing the futility of grafting onto one system (socialism) fundamental characteristics of the polar opposite system (capitalism). The next four studies deal with system change beginning with the speed of transformation, continuing with a retrospective assessment of transition after fifteen years, and concluding by drawing lessons from the great transformation for Cuba. Sandwiched in between the latter two is a fascinating philosophical essay, available in Hungarian only outside this volume, probing the meaning of system change. The final study argues for a holistic, multidisciplinary approach to systems in which institutional equilibrium is viewed as more than a sum of its parts following in the tradition of great thinkers such as Marx, Mises, Hayek, and Schumpeter. From reading this volume, I developed a deep admiration for the breadth and maturity of Kornai's scholarship and new appreciation for his insights into fundamental issues in comparative economic systems.

I was introduced to Kornai's scholarship in graduate school in 1968 when I read *Mathematical Planning of Structural Decisions* (Kornai 1967). For me, this book was an important bridge connecting the precision of mathematical models with the institutional richness of the descriptive literature on the planned economy at a time when mathematical rigor was only beginning to find its way into comparative economics. Tjalling C. Koopmans and John Michael Montias were about to pioneer the application of mathematical rigor to economics systems (Koopmans and

Montias 1971 and Montias 1976). Interestingly, Kornai writes in the book's preface: "Some decades hence, it will be natural and self-evident in Hungary to use mathematical models in preparing long-term plans" (Kornai 1967, p. vii). My next exposure to Kornai's scholarship was several years after leaving graduate school when I struggled, not entirely successfully, to understand his ideas in *Anti-Equilibrium: On Economic Systems Theory and the Tasks of Research* (Kornai 1971). In the volume under review, Kornai writes about the tensions in his own work between mathematical precision and the proper conceptualization of economic systems. "I first attempted to apply the systems paradigm in my book *Anti-Equilibrium* (Kornai 1971), but in a polemic and in many ways in a raw or half-mature form" (footnote 10, p. 190). Such refreshing self-criticism of earlier work is found in several places throughout this book. In addition, Kornai is honest and clear about the role his own values play in these studies taking care in most instances to separate positive from normative statements. For readers who know Kornai's work only from his influential writings on shortage economies and the soft budget constraint, this book is a useful introduction to the breadth and depth of the scholarship of this major intellectual figure in comparative economic systems.

Because Kornai wishes to extract the essence of systems from a positive analysis of the great transformation, a natural starting point for my review is his 1990 book, *The Road to a Free Economy: Shifting from a Socialist System—The Example of Hungary* (Kornai 1990), referred to hereafter as *Road*. Aptly, the title of the Hungarian version, which began as a lecture in Budapest in August 1989 to about-to-become policymakers in the newly elected Hungarian government, contains the phrase "passionate pamphlet." Indeed, *Road* is a personal statement from the heart of an insider who joined the Hungarian Communist party as a teenager in 1945 and experienced his own system-changing epiphany some ten years later; see Kornai (2006) for a fascinating autobiographical account of his early life and his life-long intellectual journey. The lynchpins of Kornai's vision of the new society in *Road* are political democracy and individual free choice, which he openly admits come from his own value system. Not surprisingly, a crucial political component of

the classical socialist system discussed in the first study is the dominant ideology of the single party. Two economic properties, namely, the dominance of state ownership and bureaucratic coordination of economic activity, are intertwined with this ideology to provide coherence and consistency to the resulting system. As a result, in the second study, Kornai argues that reform socialism is not a proper system but at best an unstable halfway house. As a third way, market socialism fares no better in the third study; it is denounced as nothing more than a detour from the correct road. For Kornai, a proper system requires a set of compatible institutions and not some convex combination of institutions of various types.

In *Road*, Kornai argues for an evolutionary process leading to the creation of a new private sector by eliminating all entry barriers and by hardening the soft budget constraints enjoyed by state-owned firms. In his view, a dominant state sector creates an uneven playing field and crowds out private activity. He argues against free distribution and worker ownership and in favor of sales as the proper method of privatizing state-owned firms. Revisiting *Road* ten years later in the fourth study, Kornai presents evidence from the experiences of transitioning countries to validate his conclusions about bottom-up development of the private sector and sales of state assets. However, Kornai is highly critical of his views concerning macroeconomic stability and writes: "If some miraculous time machine could take me back to that time (with my thoughts as they are today), I would rewrite the chapter before sending it to the press" (p. 75). Poignantly, this chapter in *Road* is entitled "The Surgery for Stabilization" and the sin to which he is confessing is excessive speed. Basically, Kornai faults himself for not predicting the transitional recessions that virtually all countries experienced, but I think that Kornai is being too harsh a self-critic. In *Road*, he argues that the most important macroeconomic policy problem is stopping inflation quickly. Conventional retrospection supports this position as reducing inflation to tolerable levels appears to have been a necessary condition for the resumption of growth in transitioning countries. In this study, Kornai also refers to work in the mid-1990s in which he argues that the root cause of the transitional recessions is an "institutional no-man's land" (p. 77) returning the

reader's attention to the central theme of this volume, i.e., institutional equilibrium.

The fifth study, which originated as a Presidential Address at a World Congress in 2005, is an ambitious interdisciplinary essay based partially on Hungarian contributions to economics, political science, history, and philosophy. In addition, tables of data are presented to establish that "what has taken place in Central Eastern Europe in the last decade and a half is a success story unparalleled in history" (p. 102). In addition to being the longest entry in the book, this essay may be the least satisfying of all intellectually because it fails to achieve coherent closure on the topic. Kornai appears to be grappling again with the tensions that arise from applying one's own normative values to judge outcomes that have unpleasant side effects, e.g., inequities and hardships. In contrast, although at times equally broad and philosophical, the sixth study succeeds in establishing a coherent conceptual framework for distinguishing system change from reform. Using liberal cross-referencing and contrasting clearly positive and normative statements, Kornai provides an economic definition for an economic system that can embrace all of the transforming countries because it focuses on ownership and the coordination mechanism while allowing for a monopoly political party that tolerates various institutional arrangements. Hence, China is classified as on the road to capitalism because the monopoly Communist party condones the dominance of private ownership and the market as the primary coordination mechanism.

The seventh study purports to draw lessons for Cuba from the experiences of transforming countries but does not do so in the standard way found in policy papers. Rather it is a far-reaching, relatively free-form essay that takes a broad but somewhat nuanced perspective on system change. Although the dominant theme is the free evolution of the private sector, careful attention is given to developing a complementary institutional infrastructure. This view is consistent with slow but transparent asset privatization (by sales) and the contemporaneous development of a social safety net to cushion some of the necessary adjustments during the transition. Taken as a group, these four studies offer a clear vision of Kornai's retrospective assessment of the great

transformation. His litmus test for democracy is a peaceful transfer of power at least twice. However, survival of democracy may depend on paying more attention initially both to ameliorating the negative consequences of necessary changes and to promoting the simultaneous development of all constituent parts of the institutional equilibrium. Interestingly, this lesson may have been learned by the political leaders in China but applied to maintaining single-party political dominance rather than pursuing democracy.

The capstone study extends the conceptual framework to define a system paradigm. Kornai list three conditions for a definition, namely, a set of common problems or puzzles, a common conceptual framework, and a common methodology. He argues for a holistic social-science approach and chides economists for not reading research in political science, sociology, and law. Kornai claims that a proper analysis of systems, both existing and potential, is not susceptible to mathematical rigor. He concludes by noting the futility of prediction based on a systems paradigm providing as evidence his own and others' failure to predict outcomes during the great transformation. I find these statements troubling if mathematical rigor is taken to mean applying state-of-the-arts empirical techniques to clearly specified analytical underpinnings complemented with a judicious sense for the importance of institutions and country-specific details. Kornai's failure to predict correctly in 1967 the economic situation in Hungary several decades later (Kornai 1967) does not diminish the importance of mathematical rigor in comparative economics. Rather the proper methodology for the systems paradigm must include such rigor to inform any analysis of the areas listed by Kornai as ripe for research in comparative economics, namely, the continuing development of China, variants within the capitalist system, problems that can be viewed as a system microcosm (e.g., health care), and the "global, historical transformation of the *great* capitalist system" (p. 201).

Putting systems at the forefront of research in comparative economics is a laudable accomplishment of this book. Undeniably, some background in other disciplines is important, and perhaps even essential, to producing high-quality scholarship in comparative economic systems. However, no reader should be left with the impression that

statistical analysis and mathematical rigor have no place in the new comparative economics. Following the evolution of Kornai's own ideas in this book, the reader is presented with a coherent picture of the crucial aspects of institutional equilibrium in a system paradigm. Including the mathematical rigor of Kornai's earlier work as a component of the methodology of the system paradigm adds the consistency that Kornai would, I am sure, condone. After reading this review in manuscript, Kornai wrote in an email communication to me dated April 30, 2009, that "I am very much in favor of using mathematical instruments whenever it helps understanding. However, probably there is an inverse relation between the complexity of a problem and the availability of appropriate mathematical tools. The emphasis is on the adjective appropriate."

This book is a worthwhile read for those who are not familiar with the more philosophical works of Kornai but it is also an excellent reread for those who know some or even many of these studies thanks to the value-added provided by the author's self-evaluation and the coherence added by his effective cross-referencing. In this book, Kornai elevates systems to its proper place in the new comparative economics paradigm.

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Global Warming: Looking Beyond Kyoto. Edited by Ernesto Zedillo. Washington, D.C.: Brookings Institution Press; New Haven: Yale Center for Study of Globalization, 2008. Pp. x, 237. \$62.95, cloth; \$26.95, paper. ISBN 978–0–8157–9714–2, cloth; 978–0–8157–9715–9, pbk. *JEL 2008–0716*

This volume emerged from a conference held at Yale University in 2005 and gathers luminaries in the study of climate change from across the fields of climate science, economics, and public policy. Although published three years after the initial conference, the book remains entirely relevant in terms of its stated goals and audience, aiming to provide momentum and foundational knowledge for the international community's drive towards a post-Kyoto Protocol agreement. Given the quality and clarity of the contributions, it should serve as an essential reference to those engaged in the process of negotiating the next iteration of the climate regime, while functioning as perhaps an even more important resource for students and citizens following the deliberations. By covering the latest (almost) scientific understandings and debates, perspectives on long-term economic choices and possible architectures for the climate regime, and views on climate policy from five crucial countries in both the North and the South, this excellent set of papers clearly lays out the terrain upon which climate governance plays out.

Yet this accomplishment also serves to highlight why the volume is ultimately disappointing in a crucial way and through no fault of the contributors or editor. The conclusion reached is familiar—climate change is a complex problem. The introductory chapter by Ernesto Zedillo makes the strong case that providing public goods (i.e., collective efforts at addressing climate change) is difficult in an issue like climate change when there is real scientific uncertainty (and some lingering lack of scientific consensus), long time horizons, and large and potentially unequally distributed costs and benefits. As clear and informative as the chapters are, the collective conclusion reached echoes what has been written about climate