

The return of comparative economic systems: An extension of János Kornai's contribution

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ABSTRACT

Kornai profoundly contributed to place the system to the centre of economic analysis. His multidisciplinary system paradigm is fundamental for understanding and analysing the variety of economic solutions and its consequences. The strong scientific foundation of Kornai's approach provides a fruitful opportunity to further develop and apply it to the most fundamental economic issues, such as explaining the different performance and strength of different economies and societies. The inclusion of a multidisciplinary perspective has the significant advantage of keeping under control non-economic factors that influence economic activities and performance and allows to account for the real behaviour and evolution of economies and societies. It can also contribute to explain the resilience of economic and social systems and economies. The paper takes stock of the importance of Kornai's analysis and method and applies them to better understanding the nature and working of the European Union and its difficulties. Based on Kornai's approach, the paper considers how the European Union should evolve to make itself workable and resilient in front of a threatening international environment.

KEYWORDS

European Union, Kornai, international environment, system paradigm, system, varieties of capitalism

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1. INTRODUCTION: KORNAI AND THE PROBLEMS AHEAD

The concept of economic system, its features, role and importance surged again to relevant analytical role for understanding and explaining differences among countries and their economic performance. Although traditional in economic analysis and central in various economic schools, particularly the classical one, the Austrians and also neoclassical scholars such as Lange and Schumpeter, the economic system surged to particular applied relevance during the Cold War.

The deep analytic roots of systemic analysis are in Europe. The view of the economy and the society as a complex system of institutions and actors dates back at least to Adam Smith. The classical approach proceeded through Karl Marx's criticism of the capitalist system and the inevitable transition to socialism and continued with the Austrians and neoclassicals contribution¹ to the debate on economic calculation in socialism, Schumpeter's comparison of capitalism and socialism, the study of economic reforms in socialist countries, just to mention some of the most relevant scholars and research issues. Interestingly, after its demise following the disruption of the socialist system, the discipline had recently a perhaps unforeseen surge with some interesting novelty (Andreff 2021; Dallago – Casagrande 2020, 2023; Douarin – Havrylyshyn 2021; Mizobata – Iwasaki 2023). Also important for the return of the systemic approach is the impossibility to explain the recurrent crises and difficulties of capitalist systems with standard mainstream models that neglect the systemic nature of economic phenomena.

In this renewed perspective, Kornai's research acquired a fundamental role, including the proof that any analysis must take into account those non-economic factors typically excluded from the mainstream approach. János Kornai was a prominent scholar and personality whose research belongs to the classical approach of comparative economic systems, open to a historical and systemic perspective, including the introduction of non-economic factors and a multidisciplinary approach. Yet his research gave so many important and original contributions and innovations that he and his work deserve a privileged position also in the new endeavours to innovate the discipline. His entire scientific life was devoted to this. His main interest of study was the socialist system as it was implemented in Central-Eastern Europe and in Hungary in particular. However, his analytic approach and research method have much wider and deeper significance and can be fruitfully applied to different subjects, as we aim at showing in this paper. The greatest merit of Kornai's research approach is perhaps that he recalls us to look not only to the constituent parts of an economy, but also – and primarily – at the whole and the coordination this provides to the constituent parts.

While Kornai's work is interesting and important for comparative economic studies in its own right, his concept of the *system paradigm* is of particular methodological inspiration and significance to understand the complexity of factors and variables that explain the nature, behaviour and performance of economies. In this paper we take stock of Kornai's contribution and aim at identifying how the system paradigm is precious to better understand and manage the strange case of the

¹When considering the neoclassical contribution to comparative economic systems, it is important to distinguish the approach of such authors as Lange and Schumpeter from the dominant approach of contemporary mainstream economics. Within the latter the concept of system is replaced by the aggregation of the decisions of single rational agents and there is no place for the system concept, neither for historical evolution. This had an impact on the nature of modern comparative economics and its microeconomic substance. Only recently, agent-based models started to consider, partially, the role of systemic interaction, but they do so within a context that is poorly useful for comparative economics. Also, for these reasons, Kornai's approach is important and useful.



European Union (EU). In particular, the problem we want to address is whether a group of systematically different countries can integrate by following a unique, commonly defined and designed path or whether a more flexible approach is preferable when the external environment becomes unstable and threatening and internal cohesion is at risk because of surging diverging national interests. Since Kornai's analysis refers mostly to national systems, our analysis has to depart from Kornai's under this particular aspect and give particular consideration to the rest of the world.

The following Sections 2 and 3 are devoted to present Kornai's fundamental concept: the system paradigm and the system. Sections 4 and 5 look at the EU from the perspective of the system paradigm and explain why and in which sense Kornai's analysis is important for this. Section 6 uses Kornai's concepts to show why, and in which sense the EU is living a difficult time ridden with serious dangers. Section 7 concludes with some suggestions on possible remedies.

2. THE SYSTEM PARADIGM

Kornai's analysis of the system paradigm is centered on two issues: the paradigm and the system. While the former refers at how scientific research is organized and develops, i.e., is a methodological concept, the system is the object of study that reflects a way of looking at reality. When taken together, the two concepts offer a precious compass to give order and compare the enormous variety of factors, variables and particular situations and solutions that exist in the world economies, societies and politics and better grasp their evolution possibilities. Finally, the composite concept of system paradigm can also explain and support the feasibility of reforms and systemic limits to reform, as Kornai (1986) masterfully demonstrated.

According to Kornai, who referred particularly to Kuhn (1970), the system paradigm is a "long-lasting common way of thinking by a scientific community" (Kornai 2000: 113). In Kuhn's sense, a paradigm is a multidimensional set of both scientific knowledge and of rules on scientific analysis. The heuristic importance of the system paradigm lies in that it "...provides a certain circle of researchers with the intellectual guidance".

The system paradigm has six attributes (Kornai 2000: 118–121). First, researchers are concerned with the system as a whole and with the relations between the whole and its parts. The importance of this attribute to study the EU looks natural. Second, the attention of researchers is focused on the more permanent institutions and on system-specific attributes of the operation of a society. The importance of this statement justifies Kornai in preferring to deal with "a system paradigm, rather than a transformations paradigm" when looking at post-socialist countries (Kornai 2000: 113). This attribute is fundamental in helping to get a logic of the EU beyond its many particular events and changes and the particular features of member countries.

Third, researchers must search for an explanatory theory in historical terms. Again, it would be impossible to understand the EU, its construction and evolution and its features by disregarding the role of history in promoting and forging integration and the history of each member country. Fourth, individual preferences are considered as largely the product of the system itself. A critical aspect of this non-trivial attribute when applied to the EU means that also countries should be considered along with individuals and organizations. Countries' preferences are the product of that country's system, but also of the EU system. In a sense, the same is true for individuals and organizations, that reflect to a significant extent the features of the EU system in defining their preferences, choices and behaviour.



Fifth, researchers recognize that all systems have shortcoming or dysfunctions specific to them. The importance of this attribute for the EU is supported by a long experience and a broad set of analyses. Finally, the characteristic research and analysis method is comparison. Indeed, the comparative method allows to better grasp similarities and differences and highlight the possibilities and limits of evolution and transformation of systems, including the EU both with other regions and countries and internally among member countries.

The use of the six attributes to analyse system-specific characteristics allows to define different types of systems. A question remains open: does the analytic strength of Kornai's system paradigm mean that it is important also as an applied normative guide? Having a clear understanding of the methodological property of the method and theoretical features of the system may not be sufficient to manage and transform that system. The real meaning of Kornai's preference for "a system paradigm, rather than a transformations paradigm" lies in the fact that the two are on different levels and hardly cross. Yet the former provides a benchmark and a guide to better navigate the difficult practice of reform and integration. It is necessary to properly take into consideration this warning when looking at the EU.

3. THE SYSTEM

The system is the second fundamental concept in Kornai's analysis, used consistently in his publications. However, he is prudent in giving a precise definition, in line with his consideration that the concept cannot be constrained into a clearcut frame. Even in one of his major works (Kornai 1992) he uses the term system in the title of the book but abstains from defining precisely it. However, it is fair to say that the very structure of the book as presented in the table of contents, and in particular Part two ("The anatomy of the classical system") offers a comprehensive presentation of his view and treatment of the system.

In later writings though, Kornai gives a more formal definition of the system, coherent with those provided by other scholars in different sciences.² The system consists of "...several lesser parts form a coherent whole. These parts interact. ...[T]here are comprehensible relations among them organizing them into a structure." (Kornai 2016: 549). In this definition Kornai stresses the fundamental attributes of the system: a coherent whole and the interaction among its parts generating a structure. These features explain the critical importance of the system and its stability in time even when confronted with crises, the coherence of its influence over social activity. Such role and features of the system require systemic governance³ and resilience in front of external shocks and internal strives (Csaba 2023; Aligica – Iordache 2023). Only inclusive systems have these properties (Acemoglu – Robinson 2012; Hubbard – Kane 2013; Hynes et al. 2023), since the system's fundamental values are shared, and its components are willing and able to adapt and open to change. Resilience usually implies redundancy (Aligica – Iordache 2023; Hynes et al. 2023). Redundancy means that the system includes components

²For instance, Bertalanffy (1968, p. 33)'s defines the system as "a dynamic order of parts and processes standing in mutual interaction" (1968: 208) or "complexes of elements standing in interaction". Similarly, Morin (1977: 99) defines the system as "a global unity organized by interrelations between elements, actions, or individuals".

³Systemic governance refers to how human deliberation and spontaneous outcomes interact in a system and an economy (Csaba 2023).



and has characteristics that are apparently unnecessary to its working and may survive to compensate for inefficiencies of real systems. Typical examples are private activities in socialist countries, cooperatives in capitalist countries, strategic stocks or duplications of infrastructure. Although redundancy is frequently seen as a cause of systemic inefficiency, it is often necessary to foster systemic resilience and give systemic stability in time, particularly when confronted with crises. This is an important issue in the EU, in part linked to the relation between common organs and member states and the sharing of competences.

The system, Kornai stresses is made of various constituent parts which interact. The fundamental parts are institutions. In Kornai's (2016: 579) words: "On paper an institution is seemingly independent, but in fact it is wholly controlled by people subordinate to the central will. This phenomenon is ill-considered or underestimated by the organizations making international comparisons, vital though it is to the transformation of democracy into autocracy, or even dictatorship. They are impressed by the rules expressed in formal, public words, while unaware of the background selection processes whereby the top leader and his subservient underlings place their own people in all important positions." In other words, institutions can be formal and informal and are under the influence of political power and both are fundamental components of the system. This is an important statement for understanding the EU, considering the substantial differences among member countries in informal institutions and the quality of formal institutions.

Kornai limits his presentation to the features of the system: coherence (Kornai 1992: xxv), ability "...for a long time to operate in a comparatively stable way and reproduce itself" (xxi), influence over the lives of those living within it and also outside it (p. xxi). Kornai recognizes the importance of interrelations within a system and, coherently with a long tradition on system analysis, considers that only spontaneous systems can be coherent and renew themselves, i.e., systems in which the social order is based on free interrelations that develop autonomously according to the will of single agents. With a constraining political power this spontaneity disappears and weakens the system. The lack of spontaneity means that the system lacks bottom-up legitimacy, a phenomenon that may apply to some extent to the EU.

The role of the Communist Party in socialism highlights the central role of politics in Kornai's concept of the system: "Stalinist classical socialism is repressive and inefficient, but it constitutes a coherent system. When it starts reforming itself, that coherence slackens, and its internal contradictions strengthen. In spite of generating a whole series of favourable changes, reform is doomed to fail: the socialist system is unable to renew itself internally so as to prove viable in the long run. So, the time for truly revolutionary changes does come in the end, eliminating the socialist system and leading society toward a capitalist market economy." (Kornai 1992: xxv)⁴

⁴Kornai (1992: 3–4) takes China as an example of the difficulty of dealing with systemic analysis. China can be seen from four angles: the role of the Communist Party, its being part of the Third World, being in Asia, its uniqueness in terms of population, culture, history, its policy and leadership features. Interestingly, the consequences of differences in the level of development – the key aspect of the second angle – are not elaborated further. In order to disentangle from these complexities, Kornai's book "...does not take the approach of rejecting generalization and 'common regularities' of every kind, or agree that individual features alone exist in every country. It recognizes general influences that apply in similar ways in countries that differ greatly in other respects." Moreover, the book makes "...a multicausal, multifactorial analysis of society", although it limits its attention to the dominant role of politics in general and the Communist Party in particular in the socialist system.



These observations are important, because they raise the critical issue of the relation between the economy and politics, so important for the EU. They suggest that an economy is efficient and stable only if it is based on a spontaneous social order, so that the system is legitimized from below. Within Western liberal culture, only social systems in which the interest of economic agents are dominant (capitalist systems) have this type of legitimation and stability. The market mechanism is the creative power of the capitalist system. This has much to do with the effectiveness of incentives (Welter – Xheneti 2023). This aspect is the fundamental reason for the superiority of the capitalist system, and it is its most important system-specific attribute. Yet “...a system-specific attribute is a propensity...” (Kornai 2014: 122–123). The superiority in terms of attributes does not prevent negative consequences, e.g., in terms of economically unjustified inequalities and tax evasion. In the case of the EU, the fundamental attribute is the integration of member countries, in a sense making of the EU a system of systems. However, this does not exclude the possibility of contrasting national interests that should be somehow coordinated.

There is no doubt that European integration was and is first and foremost a political process, although primarily aimed at creating better opportunities for the economy. The founding fathers of the EU believed that integration was necessary to avoid future wars and guarantee economic prosperity and applied a top-down approach with forced integration stages (“Monnet’s chain reaction”, Spolaore 2015). While the intent may be commendable, in a systemic perspective the EU is not based on a spontaneous social order and therefore is not stable and cannot renew itself autonomously but requires continuous corrective interventions.

The systemic nature of a coherent whole comes from two main sources: the coherence of constituent parts coming from the barriers to entry of alien components and the continuous interaction among its constituent parts which smooth away frictions and create interdependencies and gains from cooperation. These two aspects strengthen mutually and make the entire system coherent through mutual positive and negative feedbacks that favour adaptation and coherence between the whole and the parts.⁵ In Kornai’s words, these are fundamental attributes of the system. As Vahabi (2021) stresses, this way of defining and analyzing the system also explains its specific self-reproducing regularities. All this has a clear affinity with the issue of coordination so typical of comparative economic systems (Grossman 1967) and gets an important place also in Kornai’s research (Kornai 1983, 1990).

Kornai’s analysis shows that only better (and worse) systems exist, in reference to efficiency criteria but also of political and moral (human rights) criteria. What is clear is that the socialist system is inferior to the capitalist system because of its own features: the monopolistic power and role of the Communist Party and the dominance of state ownership, which lead to bureaucratization, soft budget constraint, and still more. Due to these features, the socialist system lacks inclusiveness and therefore strong incentives and resilience, which in the long run proved to be fatal for the survival of the system. This conclusion may rise doubts about the EU system, unless the weakness of organic processes in it are compensated by political support and participation. This has much to do with the citizens’ support and participation.

⁵These are typical features also of natural systems, see e.g., Capra (1996).



Given the inevitable failure of reforms of the socialist system (Kornai 1986), looking for a better system only refers to the capitalist system (Kornai 2014).⁶ Kornai notices two important aspects of the capitalist system. First, no real system is perfect, not even the capitalist one. Second, countries are different, including capitalist ones. Unfortunately, Kornai does not enter the debate on the varieties of capitalism (Hall – Soskice 2001; Farkas 2016), although he quotes some relevant works in this tradition.

The definition of systemic characteristics is an important chapter of Kornai's systemic analysis. In doing so Kornai follows the tradition of comparative economic systems (CES) but innovates in the way he considers the fundamental features and adopts a more complex approach. He distinguishes systemic characteristics into primary and secondary characteristics. The former determines the system as a whole and is used to distinguish economic systems from one another. Primary characteristics include political power in line with Acemoglu et al. (2005) and the new school of economic growth, the dominant form of property in line with the property rights school, and the coordination mechanism in line with the approach of comparative economic systems. Primary characteristics are sufficient to define the fundamental nature of the system. However, systems are actually more complex and under the influence of various forces and features. To account for such a variety, Kornai introduces secondary characteristics, that are determined stochastically by primary characteristics. Secondary characteristics include the working of the goods and labour markets, technical progress, income distribution, microeconomic budget constraint, corruption (Kornai 2016: 553).

This distinction is important for classification purposes and allows Kornai to distinguish countries in different groups. As always happens, sharp distinctions of complex and changing realities have the great advantage of simplification and the enfolding possibility to apply clarifying labels that highlight the essence of the given system. The reader should be careful though not to extract normative conclusions from it, a danger that Kornai is aware of by keeping the analysis in pure economic and political terms and avoiding entering the complex interaction between primary and secondary characteristics. The difficulty of analysing China based on the dominant form of property or political power when Western categories are applied in a non-Western set of institutions is a case in point (Haoxuan 2020). More important for this paper, this may also refer to the internal complexity of the EU.

Kornai is aware of this danger and repeatedly warns the reader. He does not resort to sharp distinctions and uses "...repeatedly ... words like 'dominant' and 'largely', without mention of a quantitative value for them" (Kornai 2016: 553). While characteristics stay in a hierarchical relation, this does not form a deterministic relation (Kornai 2016: 554). Although "...primary characteristics determine the system as a whole, including secondary characteristics" and "[t]he joint presence of the primary characteristics is a necessary and sufficient condition for the appearance of the secondary ones", "the primary characteristics do not generate all the secondary ones in a deterministic way. The effect is stochastic." Moreover, there are mutual effects among characteristics: "...the primary and secondary characteristics have mutual influences on each other", but "...the primary characteristics are the decisive ones, and ... the reactive

⁶It may be worth stressing that this dualism holds in the Western cultural context. Alternatives to capitalism (the "new traditional economies") exist outside the Western countries which could be stable and efficient over time (Rosser – Rosser 2023).



influence is less strong”. These warnings may make Kornai’s results less precise, but analytically stronger and useful also in a normative perspective.

4. THE SYSTEM PARADIGM AND THE EUROPEAN UNION

The concept of system paradigm is important for analysing the EU. However, to do so we must keep in mind two important features of the EU that distinguishes it from sovereign countries, the domain of Kornai’s analysis. First, the EU is based on an explicit dynamic institutional perspective and program (“ever closer Union”), which is an important part of the EU paradigm. This means that the EU system is bound to structurally change through time, is incomplete and subject to the interaction among the holders of the first level paradigm, member states. A useful way of looking at the EU paradigm is to see it as a transitory process in moving from one established set of paradigms (those of sovereign countries) to a future established paradigm (that of a fully integrated EU through an only partially organic process of interaction, planning, trial and errors and compromises), submitted to the political will of national governments and the preferences of citizens.

Second, the EU is on pair with member countries and shares sovereignty with them. The European integration process has a double level system and a double paradigm - the common ones and the national ones. In this sense the EU is the domain of an idiosyncratic type of redundancy. In fact, redundancy takes (also) the form of parallel competences, common and national ones (e.g., in higher education) and of national competences under the common surveillance mechanism (convergence parameters) (Dallago 2016). This type of redundancy was purposefully introduced to facilitate coordination and foster the progressive convergence of countries. This kind of systemic redundancy distinguishes both the EU and its member countries from sovereign countries and is part of the EU system paradigm. Yet this kind of redundancy is also source of conflicts between the EU and member countries and among member countries.

The ideal and scientific origin of the integration process and the many analyses and reports which led to the construction of the European Union (Berend 2021) justify the use of the term paradigm. The term is useful to highlight the existence of a sufficiently coherent and shared vision of the process and its expected outcome. Although contrasts exist in practical terms, they are typically overcome through discussion and interaction or, in some cases, postponement of decisions or exemption of individual countries from compliance. The most typical cases are the monetary union and the Schengen Agreement, that do not include all EU member countries. The only relevant cases of failure to reach an agreement are the rejection of the European constitution in 2005 and Brexit in 2016. The European Semester is perhaps the best example of a coordinated approach to keep national idiosyncrasies into account while pursuing common goals in respect of common institutions (Casagrande – Dallago 2022a, 2022b).

Less easy is to conclude on the existence of a coherent and stable EU system. Or, better, to define how much this system can be considered as complete. As seen above, a system is defined by its primary and secondary characteristic that also identify the boundaries of the system, i.e., the frame within which there is a regularly interdependent and interacting set of components forming a unified whole. The EU can be analysed in these terms only up to a point. The EU forms a system in two senses: first, the official vision foresees that, under the coordination of



common institutions, the pressure of consistent European action and procedures, and the active effort of member countries through structural reforms, national economic systems would converge to what is foreseen by the Eurozone paradigm. Second, the EU forms a structurally changing system by means of supranational treaties and agreements, institutional engineering, policies and reforms (ever deepening integration) towards the ideal system which go well beyond the normal organic evolution of national systems. Full convergence of national countries to the EU is not necessary in order to have an effective EU system (Casagrande – Dallago 2022b), although this issue is still unresolved.

However, missing political unification and resistance by national governments to give up further chunks of their sovereignty create discontinuity between what is foreseen in the EU paradigm and the developing EU system. National systems are different and have national institutions which may be at odds with common institutions. The most relevant cases in point are perhaps labour markets, financial systems, and defence (Hall – Soskice 2001; Hall – Thelen 2009; Tocci 2018). EU incompleteness and asymmetry and national differences are the source of difficulties of coordination, conflicts and EU ineffectiveness. Moreover, different national effects and consequences descend from common policies, which may be favourable for some countries and unfavourable for others. This further exacerbates political conflicts and economic problems and makes convergence more difficult (Dallago 2016).

Under these conditions, the EU paradigm risks being ineffective as a guide for analysis and decision making. This is particularly evident in non-standard circumstances such as a crisis or international turmoil, when the need for urgent action is great and the time perspective is short. The EU system is incomplete and is asymmetric, since national sovereignty is strong in certain domains (fiscal policies, law and order) and weak in others (monetary policies, international trade treaties, competition). This situation makes difficult to coordinate individual formal institutions, reforms and policies, let alone influence the evolution of informal institutions. In the end this situation opens the possibility that sub-optimal multiple equilibria result, which may cause coordination failures among member countries, due to their different situations, interests and goals. For instance, a fiscally balanced member country may fail to expand its economy to create demand for fiscally unbalanced member countries. This highlights a fundamental policy problem rooted in insufficient institutional integration: EU policy-making (e.g., monetary policy) needs the coordination of business cycles, which is at odds with national sovereignty of fiscal affairs. In turn, convergence parameters would require differentiated common (monetary or fiscal support) policies to be effective.

The question arises whether the EU can be analysed as a system paradigm in spite of all the above-mentioned odds. Kornai (2000: 123) provides help when he stresses that a system paradigm “...requires of its exponents the consistency of logic, with statements supported by argumentation and comparison with similar or contrasting cases. The stringency of the argumentation is increased by quantitative analysis, which has to be done wherever possible.” Equally important is that in dealing with the paradigm, history and politics should be given proper consideration. The determination of member countries, the support of citizens, the formal treaties and the everyday action in the spirit of integration should also be considered.

The EU paradigm shares the six attributes proposed by Kornai for a system paradigm. It is the outcome of scientific and intellectual effort, political and social interaction and



determination which generated a long-lasting common way of thinking. This view is shared by a large part of the scientific community, European organs, the business community and the citizens. It is also a common view at international level. Moreover, the EU paradigm survived the test of crises and time, in spite of all its problems and deficiencies. The same conclusion concerns the EU system.

Before reaching a final conclusion, we have to consider two relatively novel sets of events that are at odds with both the EU construction and evolution. The first such event is the dramatic change of the external (international) context. This change is made of two fundamental components. First is the rise of emerging countries and the relative weakening of the economic and political power of the West and the US in particular. Neoliberal policies that accompanied globalization caused a dramatic increase of domestic inequalities influencing employment, incomes, wealth and social mobility (Milanovic 2011; Piketty – Saez 2014; Atkinson 2015). Increasing inequalities changed the voting balance to the advantage of candidates with protectionist agendas (Rodrik 2021). This gave the democratic blessing to the U-turn of the US policy in the last decade and for the ongoing “dangerous decade” (Haass 2022). The relative weakening of former dominant countries causes the decline of the coordinating and governing role international institutions that were established by the dominant power (Mearsheimer 2018; von Dohnanyi 2022). International policy coordination is consequently disrupted.

Second is the dramatic change of the US attitude to the EU. For decades until the early 1970s, the US followed an enlightened and forward-looking strategy and was the effective manager of the international economy and stability. Particularly important components were the strong support given to European integration with the participation of Germany (Berend 2021), the growing partnership with Japan and the support to decolonization in the Third World. This international system created sizeable gains from cooperation and integration in the frame of globalization, that went to the advantage of the US, but also of other countries which started to effectively compete with the United States.

The most evident change in the US attitude to the world in general and the EU in particular was the election of President Trump in 2016. His slogan “Make America great again” stressed the key issue: the US was losing political and economic world primacy to the advantage of its main competitors: China and the EU. President Biden continued this approach and made it more sophisticated and expansive. Contrary to the conclusions of some analyses (Vollrath 2020), this is a problem in an open world. The US current accounts and the weakening international role of the dollar give a visual alarming picture of the weakening competitiveness of the US economy. The remarkably different growth rates of the US and China continuing for an unexpectedly long time transformed an economic problem into a political one.

The negative attitude towards the EU started much earlier though, with President Nixon who inaugurated the “pivot to Asia” and continued up to President Obama. The successful integration of the EU made the latter a formidable competitor and the main world exporter, replacing the Japanese threat effectively solved with the Plaza Agreements (Thorbecke 2023). The rise of the Euro jeopardized the role of the dollar as the overwhelming international currency. Following Brexit, the EU became potentially less a reliable partner for the USA and is increasingly seen as an effective competitor to be diluted with further enlargements (NSS 2022).



5. THE IMPORTANCE OF KORNAI'S SYSTEM PARADIGM FOR EU'S PROBLEMS

The present world is deeply different from the one Kornai had as a reference. Yet Kornai's ideas continue to provide an important source of analytic inspiration and intellectual guide, including for addressing the EU daunting problems and finding solutions. His holistic approach is particularly apt to deal with the complex and multi-level challenges the EU is meeting, both internal and external. Important differences with Kornai's original analysis are that the EU lacks a political union and that successive enlargements have increased the internal variety and contrast of national interests, that external tensions make less manageable.

Differences of interests could give a fatal blow to the integration if uncoordinated national interests prevail. However, it could also give a determinant push to move to a more viable union. The first condition for this being possible is to have a strong will at both the EU and national levels to proceed towards a better EU, which should be more inclusive, accommodating for different national situations and supporting progressive adaptation. Kornai provides a compass for identifying a viable system, with particular reference to the fundamental role of primary characteristics. The varieties of capitalism that are present in the EU require that both the EU paradigm and system foresee the need for more institutional and policy flexibility, avoiding causing permanent gains and losses. This may be obtained through a European benchmark able to guide countries towards a situation of well-being both at national and communitarian level (Casagrande – Dallago 2022b).

The time of the founding countries is gone and diverging national interests came to the forefront. The fundamental issue for the EU is to find a way of coordinating national interests within the frame of the EU and to coordinate these with the EU interest. Predictably, this concerns only fundamental interests and coordination based on fundamental principles. The EU and its organs would become more powerful and important in the core issues, more decentralized and permissive in particular issues. While in the former case the EU organs can act as a quasi-government of the member countries, in the latter countries will be able to proceed flexibly following their priorities and idiosyncratic approaches.

The debate on more or less Europe is ill-posed, since it extremizes an issue that can only be managed and solved flexibly and pragmatically. Yet, as Kornai proves, a clear framework is fundamental to identify the “normal” working of systems and their outcome. This is fundamental and urgent in a time when old problems are not solved, and new external threats give new and negative dimensions to internal problems.

Kornai's approach helps to highlight the seriousness of EU problems. Kornai's primary characteristics include: 1) The ruling political group ensures the dominance of private property and market coordination; 2) Dominant form of property: private ownership; and 3) Dominant form of coordination mechanism: market coordination. EU member countries are all capitalist countries. However, primary characteristics in the EU should include integration that comes from common will and management. This makes the overall picture more complex: there are important intercountry differences in all the three primary characteristics, as the literature on the varieties of capitalism has demonstrated. The EU is the enforcer of primary characteristics of last resort based on the letter and the spirit of Treaties and has important instruments for intervening in case of significant distortions. Although the prescriptions of the Treaties were



voluntarily defined by all member countries or freely accepted and they may be seen as the virtuous situation to which all countries should tend, the long way to that virtuous situation may be very costly to some countries. The EU does not have an institutional solution nor instruments for dealing with these effects. Since primary characteristics are permanent, advantages and disadvantages are also permanent.

The complex nature of the EU causes problematic consequences for the ways in which secondary characteristics manifest within each member country. The EU single market is a surplus market with prices that tend to converge due to the open and standardized nature of the market, despite persisting heterogeneities (Guerreiro – Mignon 2013). The question of labour surplus is more complex, due to lower mobility of labour.⁷ Labor surplus is much higher in some countries, typically in Southern Europe. There are various reasons for this, among which the rigidity of labour markets and the relatively low level of education of the labour force stand out (Hoftijzer – Gortazar 2018). This creates a disadvantage for these countries in the common labour market in the form of emigration of skilled workers and higher expenses for unemployment benefits. Although the SURE program has reached some results,⁸ the EU action in this particular field has been modest so far. Technical progress presents a similar picture. R&D investments have been traditionally left to member countries, but in recent decades the EU became increasingly important, being this an area for additional competences between the EU and member states. Differences among countries have decreased but are still important (Kijek – Matras-Bolibok 2020).

The budget constraint in the EU is generally hard. This is a fundamental prerequisite of the single market, although countries may attempt to soften it for particular companies or branches. The need to get the EU approval for state help and the need to prove that this is a transitory measure due to exceptional circumstances of strategically important companies or to natural disasters guarantee an overall acceptable behaviour of member countries, but the playing field is hardly really levelled. Oligopolistic practices, although illegal, are diffused as much as fiscal competition by some governments to the disadvantage of the others (Flamant et al. 2021). Intercountry differences are particularly significant also in the case of corruption, similarly to the spread of the criminal economy and tax evasion (e.g., Buehn – Schneider 2016). These differences put weaker countries and governments in a difficult situation in the common market. Although being unbalanced may be seen as a demerit, particularly so in the common currency area, fixing accounts is particularly difficult when countries have incomplete competences and common support is lacking or insufficient.

In conclusion, the EU is a variegated set of countries, in many respects still an aggregation of individual parts competing for their own interests, having national governments diversely committed and effective in assuring dominance of private property and market coordination. As a consequence, the quality of institutions and markets (Hubbard – Kane 2013), the protection of property rights and the nature and quality of coordination are different. The single

⁷Labour mobility is one of the fundamental components of an optimum currency area (Mundell 1961). Labour mobility in the EU is much lower than in the United States (Dallago 2016).

⁸The Support to mitigate Unemployment Risks in an Emergency (SURE) consists of loans granted on favorable terms by the EU to member countries that have to deal with increases in public spending to support employment (Vandenbroucke et al. 2020).



market went a long way to promote some intercountry convergence, yet differences remain and may be significant.

6. THE EUROPEAN UNION IN TURMOIL

Following Kornai (1992), it is true that EU member countries “resemble one another and exhibit important attributes in common”, but they do so only in rather general ways. Membership in the EU does not require that member countries must set up a radically new system, as was the case of socialist countries. The role of the European Commission as a controller and enforcer of last resort is relatively soft and disputed, while that of the European Council can be blocked by the right of each country to veto in case of unanimous decisions.

In classification terms, we can easily conclude that the EU is made of democratic capitalist countries. However, the main problem with the EU is not one of systemic classification, but one of effective functioning and goals. Indeed, it is not clear whether all countries really desire to become part of a single whole (a system of systems) sacrificing substantial parts of national sovereignty or prefer to keep a looser integration centred on the single market (an aggregation of systems). Also, for this reason a more flexible approach to integration may be desirable in this historical phase.

The EU peculiar construction made away with full sovereignty in any of the participants and highlight the fundamental importance of the system for the effective working of countries and the EU. Moreover, when competences formally belong in national governments, their decision-making power may be submitted to commonly defined rules and parameters and pressures (such as in national fiscal issues) or important parts of the competence may be in the hands of a common organ (as in the case of international trade). Therefore, the fast coordination of different organs and countries is fundamental, yet cumbersome. Moreover, lacking a compensating mechanism for the losers from common decisions, interaction and bargaining are central. Unfortunately, EU institutions were not set up to allow for fast decision-making in turbulent times, but to guarantee the coordination among member countries in normal stress-free times. Unanimity for decision making on fundamental issues such as changing the treaties is a solution for supporting coordination but does not promote fast and effective decision-making.

The EU system is incomplete and asymmetric (Dallago 2016). It is incomplete because both the EU and its member countries have incomplete institutional architectures. The former acquired or developed through time important institutions, such as (most of) the institutions of monetary sovereignty, yet it is far from being a sovereign reality. Indeed, it lacks many of the fundamental institutions of sovereign countries, such as those of financial sovereignty, but also a fully unified banking system. The EU paradigm as reflected in the treaties recognizes that the EU has an incomplete system. Member states transferred part of their sovereignty to the EU, although they did so in different ways and at different speed, e.g., the adoption of the euro involves presently 20 countries and only 11 of them adopted the euro on the date of its launch (1999 and 2002). These precedents are important to find a way out for the future.

The EU system is also asymmetric, because it is skewed to monetary integration, the single market, the European Parliament, but it misses other important components that should be



managed together for having a complete and effective system. The short side of asymmetry covers fiscal, defence, military and various others building blocks of a complete system. As a consequence, the EU has to rely on components under different supervisors, enforcers, sovereigns, makes large use of bureaucratization and lacks an effective system that only comes from completeness and symmetry.

The system could somehow work under normal circumstances, free of major instabilities and crises, although it often meets serious obstacles and remain blocked. This brings to the forefront the critical role of internal dynamics and the external environment.⁹ Lately internal dynamics became particularly complex and tense and the external environment unstable or threatening. Important events are, in the former case, different positions on expenditures for defence, the ECB policy of interest rate hikes, potential EU policy towards unemployment. In the latter case, particularly important are the international financial crisis of 2008, the migration crisis of 2015, the Covid-19 pandemic of 2020 and the war in Ukraine since 2022.

The consequences for the EU are particularly significant, since they jeopardize the internal structure and coordination and further weaken organic processes of adaptation.¹⁰ The EU weak systemic power and inability to properly coordinate national interests within a superior European interest is a major failure of European integration (von Dohnanyi 2022). Moreover, successive EU enlargements made such coordination increasingly difficult. There is a dramatic need to reform the EU paradigm and system to make it more resilient and effective.

The ongoing crisis around the war in Ukraine promises to be the most devastating one for the EU. The failure of the Minsk Agreements¹¹ and the Russian invasion of Ukraine put the EU in an unsustainable situation. The timid attempts of France and Germany to bring Ukraine and Russia to the negotiation table right before the invasion proved to be too late, too timid and not backed by the EU as such. Since then, the EU is following passively the US and the European

⁹The attribution of great importance to the external environment where the European system is deeply embedded requires that we take a somewhat different approach than Kornai's. In Kornai the secondary role of the international environment was justified by the closed character of the socialist system. Conversely, EU member countries have quite open economies. Another important difference with Kornai's main research issue is that globalization made international relations central, particularly since the disruption of the socialist system. There is a long tradition in CES attributing a central role to the external environment, starting from Koopmans and Montias (1971).

¹⁰Careful scholars as Berend (2021) and Haass (2020) stressed the dangers for the very sustainability of the EU and correctly stressed that the negative events accelerated the EU crisis more than cause it, since the EU had already lost traction for years before the external events hit.

¹¹Former Chancellor of Germany candidly admitted that Germany promoted the Minsk Agreements to give Ukraine time to strengthen militarily against Russia (*Politico.eu*, February 20, 2023, <https://www.politico.eu/article/angela-merkel-russian-pranksters-faking-petro-poroshenko/>). Similar was the content of an interview by former French President François Hollande to *Frankfurter Allgemeine Zeitung* (*The Eastern Herald*, 26 March 2023, <https://www.easternherald.com/2023/03/26/hollande-said-the-minsk-agreements-allowed-kyiv-to-strengthen-its-military-power/>).



Commission is forcing its top-down nature, presumably to increase its power over member states. And this takes place in spite of mounting doubts among member countries and the opposing views of the majority of EU citizens.¹²

What is happening is a serious deviation from the EU paradigm and is straining the system. Finding ideas and proposals for a solution are of the utmost importance. The EU needs to move towards a better construction based on its funding principles and capable of dealing with external turbulence and internal variety, sometimes incompatibility of national interests and conflicts. This requires rethinking the EU paradigm and system to avoid impairing the effectiveness of the EU construction (Puglierin – Shapiro 2023) and the direct and indirect economic harms that seriously damage economic stability and development perspective (UBS 2023). However, the most relevant danger is probably the political disruption that is proceeding mostly undercover, bad news for the EU given the central role of political cohesion for the viability of the integration process.

7. CONCLUSIONS: FOLLOWING KORNAI'S TEACHING IN SEARCH FOR A WAY OUT

The main strategic problem of the EU is completing its system and make it more symmetric. This requires changing the system paradigm. Unfortunately, this must take place amidst difficult conditions, the faltering political will of member countries, deep fissures in the political priorities and perspectives of member countries and the relations with citizens. Long-term strategic programs that were intended to afford dramatic dangers, including the environmental crisis, rebuilding health systems and creating a more solid and equitable EU, and promoting growth and development, went in the background.

Strategic programs were also meant to increase the resilience of the EU and strengthen its cohesion. Faltering political will and emerging contrasts of interests and intentions create a new situation. The perspective membership of Ukraine is bound to dramatically increase EU internal contrasts and tensions (Askew 2023). The lack of a common government also with a distributive power is a problem that cannot be eluded, nor can it be mimicked with institutional engineering. The Werner Report (1970) was prescient in this: it stressed the necessity to have a complete governance of European integration and warned of the severe problems that would descend from the inability to implement the integration agenda.

It is urgent to find a satisfying solution to avoid permanent damages to the European integration. The noteworthy variety of countries that are members of the EU and the great dangers of external shocks and unforeseen and undesirable events require that the EU reconsiders its founding principles in a new light. The existing EU system is ineffective when time is short, conditions change significantly and rapidly and taking fast coordinated decisions is fundamental. Given the wide and deep internal variety and amidst external turmoil, the existing system typically leads to inefficient bargaining and compromise, trading, requests for

¹²Interestingly, while most Eastern governments are pushing for a still harsher approach in the military support to Ukraine and the fight against Russia, the same Eastern countries pretend the EU protection and compensation for the losses to their agriculture caused by the heavily subsidized (by the EU) Ukrainian agricultural imports (<https://www.cnn.com/2023/04/19/ukraines-grain-exports-cause-divisions-among-its-european-neighbors.html>).



compensation, postponing decision-making. The prevailing time horizon is short, right when instability and tensions would require a long-term perspective. It is therefore dramatically important to find a way out of the present deadlock.

Fortunately, the basic principles for the solution are offered by the EU itself. Its founding principles, in particular the principle of subsidiarity, are the key to the solution of the present threats.¹³ The EU does not need to reinvent itself. Some ideas and initiatives, discusses and adopted particularly after the Covid-19 pandemic, offer promising suggestions and examples. The solution lies in a more complete EU system, which means both deepening integration (a more complete system) and making it more flexible (coordinate EU and national interests).

The most promising steps to a more resilient and stronger EU come from the EU reaction to the recent internal and external difficulties and threats. These are the NextGenerationEU and the European Green Deal. These programs show that the EU can enlarge and deepening its role under the leadership of the European Commission and taking a more flexible attitude better apt to the needs of each member country. At the same time, there are serious problems and dangers in the management of these programs that should not be underestimated. This problem is now even more serious due to the entry of REPowerEU in the NextGenerationEU and the growing military expenditure financed with these funds.¹⁴

To pursue a feasible and sustainable future of European integration requires to work on the relation between common organs and member states. Preconditions for this is to have a better coordinated and autonomous strategic posture in international affairs and proceed cautiously in increasing internal variety through the membership of additional countries. The motto for the next years should be consolidation by flexibility. It is also important that the EU does not innovate through ad hoc, one-shot programs. These programs should be structurally linked together in order to promote cooperation among member countries and avoid opportunism and free riding. The behaviour of countries should be carefully assessed based on preannounced and transparent parameters and countries should have consequences for non-compliance.

NextGenerationEU offers a good example. The program was launched after long debate in response to the unforeseen threat of the Covid-19 pandemic and its serious negative economic and social consequences. These were significantly worse than the negative consequences of the

¹³"The principle of subsidiarity is defined in Article 5(3) of the Treaty on European Union. It aims to ensure that decisions are taken at the closest possible level to the citizen and that constant checks are made to verify that action at the European Union (EU) level is justified in light of the possibilities available at the national, regional or local level. Specifically, it is the principle whereby the EU does not take action (except in the areas that fall within its exclusive jurisdiction), unless it is more effective than action taken at the national, regional or local level. It is closely linked to the principle of proportionality, which requires that any action taken by the EU not go beyond what is necessary to achieve the aims of the treaties. Another related principle, the principle of conferral, states that any policy areas not explicitly agreed in the treaties by all EU Member States remain in their domain." (<https://eur-lex.europa.eu/EN/legal-content/glossary/principle-of-subsidiarity.html>)

¹⁴In 2023, as a consequence of the war in Ukraine, the European Commission proposed the Act in Support of Ammunition Production (ASAP) (European Commission 2023). ASAP is a response to the Council's call to ramp-up EU weapon production capacity to support Ukraine and refill Member States stocks. European member countries will apparently rely also on funds from the EU budget and use the Recovery and Resilience Facility funds. Moreover, the Joint European action for more affordable, secure and sustainable energy (REPowerEU) has been embedded into NGEU so that to promote member countries energy independence from Russia. The US and European Commission have confirmed their strategic energy cooperation.



2008 international crisis, but there were also significant differences among countries. Considering that the negative effects of the pandemic were due mainly to exogenous factors and not to the mismanagement of economies, the EU and national governments agreed to set up a new financial instrument to support countries in proportion to the negative consequences they suffered (Table 1). The instrument had to be managed by the EU, in large part with resources obtained through markets using the strong financial reputation of the EU, i.e., at significantly lower costs than national governments in difficulty would have paid to market lenders. Moreover, this mutualization of debt was in significant part given to disadvantaged countries as donations free of charge. Another part was given as very long-term loans (repayable within 2058) at low interest rates.¹⁵ In exchange for support, member countries had to prepare national plans of resilience and development, to be submitted to the approval of the European Commission, which also provided rigorous screening of the different time-sections of the plan. The support is paid after a positive evaluation and constitutes a stronger enforcement of national commitments that in other cases. The aim was to upgrade the communitarian significance of EU integration, avoid jeopardizing the solidity of the euro and disrupting the single market.

In spite of difficulties and dangers, the instrument is working. Remarkable is that it put an end to the usual endless series of recriminations against the EU by countries in difficulty, since now it is countries that have to prove that they are able to properly use free or cheap resources that the EU provides. This also put national governments under pressure to devise strategically important programs and make their national structures – starting from public administrations – work properly and reform them when necessary. This is a solid idea, since it reverses responsibility and, if necessary, blame. Moreover, it introduces an important flexibility in the so-far nearly monolithic EU approach, with the minor exception of the European Semester (Casagrande – Dallago 2022a). Countries are treated according to their different conditions and supported according to their situations and needs and assessed according to their implementation of the selected programs.

NextGenerationEU is in sharp contrast with previous EU reactions to unforeseen threats. In the case of the 2008 and 2011 financial crises and in the 2015 Greek crisis, the EU approach was to blame distressed countries and impose costs of recovery in direct proportion to the stress. The outcome was to make the euro safe at the cost of making the crisis worse and further increase distress (Dallago 2016). In the case of the migration crisis, which reached its climax in 2015 (Berend 2021), the EU attempted to distribute immigrants according to criteria able to consider the cost of integration in each member country (Altemeyer-Bartscher et al. 2016). The lack of clarity about these criteria (e.g., the compensation mechanism for those countries more exposed to refugees' inflows), and the opposition of various member countries made the plan fail and the negative effects of the crisis hit primarily countries of first entrance (particularly Greece and Italy), albeit with some financial support by the EU.

NextGenerationEU is a costly program, but the basic idea can be extended to other programs and to the relation between common organs and member countries. In short, the EU should concentrate on the fundamental issues and become more effective, if necessary, also through instruments to equalize the effects. The present setup and activity of the EU may jeopardize the

¹⁵Grants amounts to €312.5 billion and loans to €360 billion at 2018 prices. The total financial sources of NGEU, which include other funds, amount to €750 overall (<https://www.ngeutracker.org>).



Table 1. Member countries Recovery and Resilience plans amounts (million €)

Country	Grants amount	Loan amount	Total RRF amount
Austria	3,461.4	0.0	3,461.4
Belgium	5,924.0	0.0	5,924.0
Bulgaria	6,267.3	0.0	6,267.3
Croatia	6,295.4	0.0	6,295.4
Cyprus	1,005.9	200.3	1,206.3
Czechia	7,035.7	0.0	7,035.7
Denmark	1,551.4	0.0	1,551.4
Estonia	969.3	0.0	969.3
Finland	2,085.3	0.0	2,085.3
France	39,368.3	0.0	39,368.3
Germany	25,613.5	0.0	25,613.5
Greece	17,769.9	12,727.5	30,497.5
Hungary	5,811.1	0.0	5,811.1
Ireland	989.0	0.0	989.0
Italy	68,880.5	122,601.8	191,482.3
Latvia	1,826.0	0.0	1,826.0
Lithuania	2,224.2	0.0	2,224.2
Luxembourg	93.4	0.0	93.4
Malta	316.4	0.0	316.4
Netherlands	4,707.1	0.0	4,707.1
Poland	23,851.7	11,506.5	35,358.2
Portugal	13,907.3	2,699.0	16,606.3
Romania	14,239.7	14,942.2	29,181.8
Slovakia	6,328.6	0.0	6,328.6
Slovenia	1,776.9	705.4	2,482.3
Spain	69,512.6	0.0	69,512.6
Sweden	3,288.5	0.0	3,288.5

Source of data: NGEU tracker. <https://www.ngeutracker.org/recovery-resilience-plans>.

neutrality of EU rules and policies, as a consequence of which the same rules or policies may have quite different consequences for different countries. NextGenerationEU shows one possible solution to this important problem. Member countries should be free to choose the form of their



engagement and participation in all those cases when this does not have negative spillovers for other countries or the core integration process. Countries participating in common institutions or programs should bear direct responsibility for the common success. Systemic governance should be properly adapted. This situation potentially already exists: monetary integration is of the former type together with the four fundamental freedoms that are at the basis of the EU, the free circulation of people is limited to the countries of the Schengen area. This approach follows Kornai's systemic characteristics but takes into consideration that the EU lacks fundamental attributes of a state and have others which derive from the integration.

Moving consistently in this direction requires that the EU and member countries reconsider the EU paradigm and system with particular consideration for external threats and internal tensions. If the EU cannot become soon a true union with a true government, it should take on an architecture that gives solidity to a less ambitious construction. This requires to match Kornai's system paradigm perspective with his analysis of the transformation of the system, in reference to the importance and limits of reforms. Moreover, it is necessary to add inter-country relations and those with the European Commission that Kornai had not to consider in the case of sovereign countries. This leads inevitably – as the [Werner Report \(1970\)](#) suggests and European Treaties make clear – to the need to activate flexible solutions ([Dallago – Rosefeldt 2021](#)). With proper common political will, this can move patiently countries and common organs towards a better integrated system.

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