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Rejoinder to *The motivation of business leaders in socialist and market-based systems* by Péter Mihályi

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This rejoinder has the following two aims. First, Mihályi's analysis is further developed and shown that, in spite of the common motivation across the two economic systems, the behaviour of business leaders can lead to divergent results. Namely, certain managerial decisions can create a disequilibrium mechanism leading to recessions. Second, the current state of macroeconomics is commented upon.

Listing the recent financial crisis, dot-com bubble, and the Maxwell collapse in the early 1990s, Mihályi (2017) indicated that corporate governance, i.e. the process of managing multinational companies is a recurring topic after each major collapse. In "The motivation of business leaders in socialist and market-based systems", Mihályi (2017, p. 12) put forth the argument according to which "the motivation of business leaders in present-day market economies is in many ways similar to the top managers of state owned enterprises (SOEs) under socialism. Despite the common motivation indicated also by Kornai (1971), who highlighted that "educated humans in the modern world function similarly under all circumstances" cited in *The motivation of business leaders in socialist and market-based systems* (Mihályi, 2017, p. 12), managers' actions can be followed by very different results due to the divergent situational settings.

Mihalyi (2017, p. 4) listed the following six differences between state-owned enterprises and corporations: (1) dependency/separation of companies, (2) the degree of liability of owners, (3) the power of stakeholders, (4) the undertaking of strategic decisions, (5) constant/revocable investment and (6) the role of companies' names. In state-owned enterprises, the level of responsibility is

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not strictly defined: "[t]he totalitarian leader's and the state apparatus' responsibilities are not defined" (Mihalyi, 2017, p. 4). On the contrary, the liability of stakeholders in the market economy is limited to the amount of invested capital. Putting aside the fact that the difference between these two species of economic system is liquid,[2] it can be generalized that companies operating in the socialist economies are unlikely to go bankrupt due to the soft budget constraint (Lin & Tan 1999).

Additionally, Mihalyi (2017, p. 9) summarized Kornai's (1994, p. 118-121) views on the factors motivating managers and listed (1) accepting the current political ideology,[3] (2) being committed to the job, (3) being attracted by power, (4) the prestige of their job, (5) financial benefits, (6) avoiding conflicts and (7) fear of punishment. In addition to the tacit, internal motivation, managers in both the socialist and free-market economy were awarded a fraction of their company's profits. In the socialist countries, the "top SOE managers were given a certain percentage of the enterprise's profit as a bonus" Mihalyi 2017, p. 5). In free-market corporations, managers are usually awarded call stock options (Shin and Seo 2011) that motivates them to undertake actions aimed at raising the value of the company. In summary, contrary to the neoclassical economics view, Kornai (1971) and Mihalyi (2017) argued that profit maximization is only one of the factors that drive managers. In addition managerial decisions are shaped by a number of tacit factors that make their work likable on its own (disregarding the salary). Therefore managers are likely to undertake such decisions that will result in prolonging their contracts instead of acting in line with the profit-maximization assumption.

Kornai (1994, p. 39) listed "the macroeconomic consequences of the hardening of financial discipline" as one of the reasons for the transformational recession suffered by the post-socialist countries in the early 1990s. In other words, one of the differences in the institutional settings between free-market economy corporations and socialist state-owned enterprises is the flexibility of the budget constraint. If SOEs happened to have difficulty in liquidity, a state government would deliver money and would not allow the collapse.[4] On the contrary, as Kornai (1994, p. 49) put it, "a private firm is under a hard budget constraint (…)". In spite of Kornai's (1994, p. 50) belief that "[i]n the long term efficiency and thereby growth will be increased by the spread of private ownership, the privatization of assets previously owned by the state and the enforcement of the financial discipline, a hard budget constraint, in all sectors of the economy", under particular circumstances, the behaviour of profit-

[2] The recent financial crisis and other economic turbulences showed that when a collapsing company is believed to be too big to fail, government acts as if it operated it.

[3] Therefore, managers employed in companies operating in the free-market economy are likely to accept the (neo-)liberal ideology.

[4] It should be noted that the influence of the flexible budget constraint on the efficiency of economic activity in the long run is excluded from the discussion.

maximizing companies can create macroeconomic turbulence. In this case, if managers choose a strategy that produces a steady level of profits and a very unlikely chance of collapse (called by Taleb (2010) the black swan), their behaviour can potentially be a disequilibrium mechanism. Companies governed in this way are profitable as long as the rare event occurs. A notable example of such a disequilibrium mechanism is the case of AIG that, before the 2007-2008 financial crisis, produced a fraction of profit selling CDS (credit-default swaps). The strategy is secure and profitable unless the house-market bubble explodes (Stulz, 2010).

As Soros (1994, p. 27) indicated over twenty years ago, "[e]conomic theory is devoted to the study of equilibrium positions [because] [i]t allows us to focus on the final outcome rather than on the process that leads up to it". In spite of a few exceptions focusing on economics, the emphasis of the mainstream economics is put on analyzing the state of equilibrium. This viewpoint can be exemplified with the neoclassical synthesis that "was not really a synthesis of neoclassical with Keynesian ideas (as it purported to be) but merely the reassertion of the neoclassical framework with the addition of some Keynesian "macro" terminology" (Davidson, 1990, p. 151). Even the Keynesian economics, a theory established as a response to the Great Recession, has little to say about the causes of recession and, on the contrary, focuses on stimulating economic policy.[5] For instance, Krugman (2009) indicated the lack of considerations focused on crisis and the mechanisms promoting crisis in economics: "this romanticized and sanitized vision of the economy led most economists to ignore all the things that can go wrong. They turned a blind eye to the limitations of human rationality that often lead to bubbles and busts; to the problem of institutions that run amok; to the imperfections of markets (…)" (p. 2). Even the recent analyses focusing on disequilibrium looked for the causes of recession in line with the Keynesian views, indicating, for example, the lack of access to bank loans and unequal income distribution (Gebremeskel (2017) or, as usual, the disequilibrium between the demand for, and supply of, money. Contrary to the current practice of macroeconomists, analyzing the mechanisms that take economies out of the equilibrium state is unavoidable if economics is expected to deliver applicable and effective countermeasures[6] that are aimed not only at intervening when the levels of demand are insufficient, but setting up the institutional environment promoting a constant growth.

[5] It should be noted that the Keynesian theory states that economic crises and recessions are caused by an insufficient level of demand caused by the investment-saving imbalances, but the underlying causal mechanisms were not considered in detail. For instance, Farmer (2012) delivered evidence according to which the 2008 crisis was triggered by a decline of house prices, but did not ask the question about the causes of the bubble.

[6] Cf. (Grüne-Yanoff 2016; Maziarz 2017) for arguments as to why delivering the mechanistic evidence instead of correlational or functional analysis is essential for identifying recessionary causal factors and effective policy making.

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