
The Soft Budget Constraint

The Emergence, Persistence
and Logic of an Institution

Gun Eriksson Skoog



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Soft Budget Constraint

Eric Maskin, Chenggang Xu



Soft Budget Constraint:

The Soft Budget Constraint — The Emergence, Persistence and Logic of an Institution Gun Eriksson Skoog, 2000-11-30

The soft budget constraint today a popular metaphor is a paradox In socialist economies it implies that the state tends to bail out state owned firms in financial trouble in spite of the tremendous performance problems of the entire system that result When the socialist system broke down the soft budget constraint was expected to disappear However it seems to persist and its persistence appears to hamper the transition process itself The Soft Budget Constraint The Emergence Persistence and Logic of an Institution seeks an answer to this paradox It aims at increasing our understanding of why the soft budget constraint exists By investigating state owned enterprises in Tanzania before during and after socialism the prevalence of the soft budget constraint is examined and an explanation of its existence is suggested The approach is institutional The soft budget constraint is defined as an informal institution and an invisible hand explanation of its emergence persistence and logic is applied The book shows that the soft budget constraint emerged as an unintended consequence of the establishment of the Tanzania socialist system in the 1970s A behavioral solution to recurrent systemic problems was offered and thus the soft budget constraint performed several functions Once established its very existence set off a cumulative process of self generation Four reinforcement mechanisms that accounted for its maintenance during Tanzanian socialism are identified Its character as an informal rule helps to explain why it persisted during market oriented reform initiated in the mid 1980s The soft budget constraint was part of the socialist heritage was adapted to systemic change and influenced the direction and character of this change

A Theory of the Soft-budget Constraint Chong-en Bai, Yijiang Wang, 1995

Soft Budget Constraint Theories Eric Maskin, Chenggang Xu, 2010 This paper surveys the theoretical literature on the effect of soft budget constraints on economies in transition from centralization to capitalism it also reviews our understanding of soft budget constraints in general It focuses on the conception of the soft budget constraint syndrome as a commitment problem We show that the two features of soft budget constraints in centralized economies ex post renegotiation of firms financial plans and a close administrative relationship between firms and the centre are intrinsically related We examine a series of theories based on the commitment problem approach that explain shortage lack of innovation in centralized economies devolution and banking reform in transition economies Moreover we argue that soft budget constraints also have an influence on major issues in economics such as the determination of the boundaries and capital structure of a firm Finally we show that soft budget constraints theory sheds light on financial crises and economic growth

Soft Budget Constraints, Firm Commitments and the Social Safety Net International Monetary Fund, 1991-10-01 It is shown that the inefficiencies created by the soft budget constraint enjoyed by enterprises in Eastern Europe and elsewhere will continue so long as governments are unable credibly to threaten not to bail out loss makers Commitment to a hard budget constraint can best be achieved by the institution of a suitable social safety net The burden on the social safety net can be reduced by the

endogenous development of financial markets

The Soft Budget Constraint — The Emergence, Persistence and Logic of an Institution Gun Eriksson Skoog, 2013-04-18 This is a story of the soft budget constraint It seeks an answer to a paradox the prevalence of the soft budget constraint in spite of the tremendous inefficiencies that it gives rise to and its persistence in spite of reform of the system of which it is an integral part The story aims at increasing our understanding of why the phenomenon exists By studying the case of state in Tanzania before during and after socialism an explanation of the owned enterprises emergence persistence and logic of the soft budget constraint is suggested This introductory chapter presents an argument showing why this story is worth telling It discusses the research topic and how the problem it presents is attacked THE SOFT BUDGET CONSTRAINT The soft budget constraint is today a popular metaphor Originally it was seen as a characteristic of the socialist system It refers to the tendency of primarily state owned enterprises to have their liquidity gaps or losses accommodated by the state or some other external funding body and to the resulting expectations of such bail out The concept was coined by the Hungarian economist János Kornai He distinguishes between four major forms of external financial assistance that contribute to the soft budget constraint soft subsidies soft taxation soft credit and soft administrative pricing

The Soft Budget Constraint János Kornai, 2000 [Causes of the Soft Budget Constraint](#) David D. Li, Minsong Liang, 1998

A Political Economy Theory of the Soft Budget Constraint James A. Robinson, Ragnar Torvik, 2005 Why do soft budget constraints exist and persist In this paper we argue that the prevalence of soft budget constraints can be best explained by the political desirability of softness We develop a political economy model where politicians cannot commit to policies that are not ex post optimal We show that because of the dynamic commitment problem inherent in the soft budget constraint politicians can in essence commit to make transfers to entrepreneurs which otherwise they would not be able to do This encourages such entrepreneurs to vote for them Though the soft budget constraint may induce economic inefficiency it may be politically rational because it influences the outcomes of elections In consequence even when information is complete politicians may fund bad projects which they anticipate they will have to bail out in the future

Professional Team Sports and the Soft Budget Constraint Storm, Rasmus K., Nielsen, Klaus, Havran, Zsolt, 2022-09-08 Exploring why professional team sport clubs are almost always able to survive despite financial mismanagement inflated player salaries and persistent deficits this book provides new evidence on how to explain this phenomenon It looks at the context in which many clubs operate the soft budget constraint and how the clubs in this respect resemble state owned enterprises in socialist countries or big banks in financial crises

Soft Budget Constraints and the Dual Track System Jiahua Che, 2000 I put forward a new theoretical framework to analyze the relationship between soft budget constraint syndrome and the economic performances of firms It differs from the existing theoretical framework à la Dewatripont and Maskin 1995 in the soft budget constraint literature In this paper soft budget constraint syndrome arises when firms that are expected to lose money are financed The paper highlights a trade off between hard and soft budget

constraints While soft budget constraints may compromise firms incentives to improve performances an all out effort to harden budget constraints may put macro stability at risk especially for economies suffering from allocative inefficiency Based on this trade off the paper shows that a transition from centralized financing to decentralized financing in fact compromises firms incentives to improve their performances whereas a transition from centralized financing to a financial dual track system enhances efficiency In the financial dual track system budget constraints are soft in the centralized track but the macro stability of the economy is assured as a result The macro stability enhances the disciplinary effect of hard budget constraints in the decentralized track which in turn promotes firms incentives to improve performances The paper sheds light on a complementary relation between soft budget constraint syndrome in the state sector i e the centralized track and the remarkable growth of the non state sector i e the decentralized track in China

Soft Budget Constraints, Firm Commitments and the Social Safety Net Daniel C. L. Hardy,1991 *NOTES FOR AN ESSAY ON THE SOFT BUDGET CONSTRAINT* LORAND AMBRUS-LAKATOS,1997 **The Place of the Soft Budget Constraint Syndrome in Economic Theory** Janos Kornai,2000

The concept of the budget constraint previously applied mainly to household decisions was extended to enterprises and other organizations initially by Kornai for socialist economies The more general phenomenon usually includes rent seeking although not all rent seeking behavior is associated with a soft budget constraint SBC Rather SBC analysis is a theory of exit or more precisely of the demise of organizations Moreover the syndrome cannot be treated as a special case of the theory of regulation because not all price regulation softens the budget constraint The SBC can emerge in nonregulated spheres especially when financial interactions take place in vertical relationships between superiors and subordinates rather than in horizontal market conditions *The impact of fiscal decentralization and the soft budget constraint on the local government debt* David Onditi,2019-12-09 Essay from the year 2019 in the subject Business economics Economic Policy grade A University of Nairobi School of Business course PhD Economics language English abstract The author aims to study the impacts of fiscal decentralization and soft budget constraint on the scale of local government debts Moreover the effect of soft budget constraint on the scale of local government debt under the different extent of fiscal decentralization will be discussed Due to the linkage between economic growth and the fiscal decentralization the expansion in the local government debt is closely related to the fiscal decentralization and the soft budget constraint SBC the expectation that the local governments would be bailed out by the central government if they face debt challenges Based on the literature fiscal decentralization is linked to local government debts as literature indicates that fiscal decentralization leads to the decentralization of the expenditure without the revenue collection powers The Chinese local governments have increased expenditure budgets on public services but the powers of taxation are centralized To bridge the revenue gaps the local governments take up debts that are sunk into infrastructure and other low revenue generating investments Soft budget constraints are thus a product of fiscal decentralization as they are based on the principal agent relationship between the

politicians and the voters central government and local government and the local governments and the SOEs within the local jurisdictions

Soft Budget Constraint Theories Eric Maskin, Chenggang Xu, 2001

The soft budget constraint and transition economies Chong-En Bai, 2001

The fiscal policy and soft budget constraints of China Diffrine Madara, 2020-02-18

Academic Paper from the year 2019 in the subject Politics Region Far East grade A language English abstract This work provides a critical review and discussion of studies that have been conducted in the past regarding the fiscal policy and soft budget constraints of China The author explains the concept of fiscal sustainability and reviews some of the fiscal policies adopted by China to realise fiscal sustainability The author also evaluates the challenges towards attaining fiscal sustainability in China and discusses the the concept of soft budget constraint and how it has been cultivated into China s fiscal policies

Recent Theoretical Work on the Soft Budget Constraint Eric Maskin, 2010 The soft budget constraint syndrome first identified and studied by Janos Kornai arises when a seemingly unprofitable enterprise is bailed out by the government or the enterprise s creditors In other words the enterprise is not held to a fixed budget but finds its budget constraint softened by the infusion of additional credit when it is on the verge of failure In this paper I examine some recent theoretical analyses of this phenomenon

The Soft Budget Constraint Problem in Transition and Developing Countries Xavier Fromaget, 2008

Soft budget constraints and the fate of economic reforms in transition economies and developing countries Martin Raiser, 1996 For over a decade a large number of governments have embarked on economic reforms to strengthen the competitiveness of their countries in the world market and improve the standards of living of their populations By far the most extensive reforms both in depth and scope have occurred since the late 1980s in the former communist economies of Central and Eastern Europe and East Asia Despite vast differences in initial conditions and reform design Martin Raiser argues that a central ingredient of the success of these reforms must be the hardening of the budget constraint for domestic producers To verify this hypothesis Raiser develops an analytical framework that links the concept of the soft budget constraint to issues of economic reform in developing countries and examines indicators of the degree of budget softness with particular emphasis on the institutional deficiencies that may undermine the credibility of macroeconomic stabilization and the effectiveness of price signals In his empirical analysis Raiser relates the indicators of budget softness to the inflation and growth records of thirty one developing countries The cases of Poland and China further illuminate his theory by pointing toward the institutional arrangements that may hinder the effective hardening of budget constraints in transition economies Finally Raiser analyzes enterprise level data for China to verify the link between budget softness and technical and allocative inefficiency Soft Budget Constraints will be of notable interest to those scholars and students of economics specializing in development and transition economics

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