

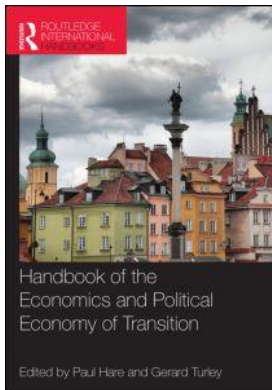
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### **Why did Transition Happen?**

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# WHY DID TRANSITION HAPPEN?

*David M. Kotz*

### **Introduction**

In the mid-1970s Soviet-type systems occupied a major part of the world. The list of states with Soviet-type economic and political systems, characterized by state ownership, central planning, and rule by a Communist Party, included the USSR, Bulgaria, Czechoslovakia, the German Democratic Republic (GDR), Hungary, Poland, Romania, Albania, China, Mongolia, Vietnam, Cambodia, Laos, North Korea and Cuba. A number of other states in Asia and Africa had adopted some features of the Soviet-type system, although not rule by a Communist Party.<sup>1</sup>

At that time, the Soviet-type system appeared stable and even unassailable. Under that system, often called 'state socialism', the USSR had developed rapidly from a rural, agricultural country in the late 1920s to an urban, industrial society. It had become one of the world's two superpowers. The USSR was a world leader in science and some areas of technology, launching the world's first space satellite. According to estimates by the US Central Intelligence Agency, in 1975 Soviet GNP was about 60 per cent of that of the USA. If Soviet and US GNP growth rates had both remained at their averages during 1950–75 that were widely accepted at the time, then in 36 more years Soviet GNP would have surpassed that of the USA, in 2011 (Kotz and Weir, 2007, pp. 33–37).<sup>2</sup>

China, starting from an underdeveloped economy in 1949, had, despite periodic disruptions from political-economic zigzags, built a significant industrial base through central planning by the mid-1970s. The Vietnamese Communists in North Vietnam had just expelled the USA from Vietnam, uniting the whole country under Communist Party rule. At that time Cuba's version of state socialism attracted wide interest in Latin America and Africa and among intellectuals in many countries.

In a remarkable historical turnaround, some 15 years later state socialism had vanished, or was gradually disappearing, in almost every state on the above list. State socialism was abandoned and was replaced by an effort to build the rival system of capitalism. The most powerful of that group of states, the USSR, disintegrated into 15 separate countries. Such a sudden collapse of a mighty economic, political, and social system, absent either violent revolution or external invasion, is unprecedented in modern history. Why did such a remarkable transition happen?

The demise of state socialism occurred very rapidly, in 1989–91, in the USSR, the seven Communist-ruled states in East/Central Europe, and Mongolia. In those states, within a few

short years the institutions of state socialism were dismantled and Communist Party rule was overthrown, with a quick shift to building a capitalist system. In China the process was one of gradual evolution over several decades starting in 1978, with the Communist Party holding onto power while the key economic institutions of state socialism – state-owned enterprises and central planning – were gradually replaced by those of capitalism, namely private enterprise and production for profit in the market. The share of industrial output produced by state-owned enterprises did not fall below 50 per cent until the early 1990s. A similar gradual transition began somewhat later in Vietnam.

This contribution examines the reasons why this transition took place in one particularly important state, the USSR. In March 1985 Mikhail Gorbachev became General Secretary of the Soviet Communist Party and soon launched an effort to reform and democratize Soviet socialism, known as *perestroika*. Six years later state socialism was dismantled and replaced by an effort to build capitalism, the Soviet state ceased to exist on December 31 1991, and Gorbachev's opponent, Boris Yeltsin, was in charge of the newly independent Russian state. Analyzing this process in the USSR during the period 1985–91 helps to understand, not just that specific case, but the entire process of transition in all of the countries. State socialism first arose in the USSR, and that model was copied, more or less closely, by all of the other Communist-ruled states. Each individual case of transition had its own particular features and developments. Nevertheless, it will be argued here that the key to understanding why the entire momentous, and largely unforeseen, transition occurred can be found in the process that emerged in the USSR during 1985–91.

### Contending explanations

There remain many contending explanations 20 years after the demise of the Soviet Union. This is not surprising – historians still debate the reasons for the decline and fall of the (Western) Roman Empire roughly 1,600 years ago. The contending explanations of the Soviet demise fall into several distinct and sometimes contradictory categories. Some authors cite factors external to the USSR while others point to internal developments. Some focus on chance, or accidental, occurrences, while others emphasize systemic factors. Among the explanations that centre around systemic factors, some claim that an irresolvable flaw was present in state socialism from the start, while others assert that problems arising from the evolution of the system account for its demise. Some stress economic factors, some political factors, and still others point to cultural factors.

This section reviews several widely disseminated explanations for the Soviet demise, arguing briefly that none of them can adequately account for it. The following section proposes an explanation that, in our view, fits the historical evidence in the Soviet case, explains otherwise puzzling features of the Soviet demise, and can also explain why (and to some degree, how) a similar process, of either a rapid or gradual character, took hold in almost all of the other state socialist systems – as well as explaining why that process has not so far spread to Cuba.

Two related explanations start with an assumption that the centrally planned economy contained irresolvable contradictions that caused an economic collapse, leaving no choice but to adopt the only alternative system for a large-scale state capitalism. The first version of this explanation asserts that central planning can work only for the basic industrialization stage of economic development. According to this view, initial industrialization involves a few key tasks – constructing the necessary transportation, power, and other infrastructure; building a few basic producer goods and consumer goods industries; and shifting the labour force from agricultural work to the various new non-agricultural pursuits. Central planning can effectively mobilize resources to accomplish such key tasks.

According to this view, once industrialization is completed central planning becomes unworkable in the face of the more complex economic demands of a post-industrialization economy. However, this explanation has a problem. By the eve of the Second World War, the Soviet Union had, in record time, completed basic industrialization. Nevertheless, the Soviet economy continued to grow relatively rapidly following postwar reconstruction from 1950 to 1975, with an average annual GNP growth rate of 4.8 per cent in that period based on CIA estimates (Kotz and Weir, 2007, p. 35). Soviet central planning did not collapse after basic industrialization was completed; rather, it continued to function remarkably effectively.

The second version of this explanation holds that central planning can work both for industrialization and for the following stage of the initial building of an urban consumer society. The latter second stage, like industrialization, still has a few key goals – building apartments for the rising urban population, producing basic consumer amenities such as refrigerators and television sets, and producing the infrastructure and public goods for the new urban population (transportation, sanitary facilities, educational institutions, parks, and so forth). However, according to this explanation, once the initial building of an urban consumer society is completed, consumer needs become much more complex, as do the number and quality requirements for producer goods, and central planning becomes unworkable in the face of this third stage of economic development.

The assumptions behind this version appear plausible. The economic performance of the Soviet economy did sharply deteriorate after 1975, with the estimated GNP growth rate falling to the 1.8–1.9 per cent range in 1975–85 (prior to the major economic reform efforts that followed). However, slow economic growth indicates stagnation, not economic collapse. The flaw in this explanation is, once again, a problem of timing. The Soviet economy did not have a single year of economic contraction after the Second World War until 1990, when GNP fell by 2.5 per cent, followed by a precipitous double-digit fall in 1991. However, the final appearance of something like economic collapse came only when political developments in the USSR led to the dismantling of central planning and the separation of the 15 constituent republics of the economically highly-integrated USSR in 1990–91 (Kotz and Weir, 2007, Ch. 5). Central planning in the USSR never did produce the predicted economic collapse – instead, economic collapse came only when central planning was dismantled by its political opponents, leaving a disintegrating USSR with no functioning system of economic coordination in place, neither market forces nor central planning. In other words, disintegration left behind an institutional vacuum.

Another explanation cites a loss of legitimacy of the state socialist system in the USSR as the cause of its demise (Fukuyama, 1993; Kontorovich, 1993). There is ample evidence that a major part of the Soviet population became disenchanted with the official ideology. There were many glaring contradictions between the official ideology and the readily observable reality of Soviet life, such as that between the pretension of economic equality and the special privileges of the ruling elite. The promised world revolution, after seeming to progress for a time at least in the less economically developed part of the world, appeared to stall after the 1970s. The pre-1975 economic catch-up with the West seemed to go into reverse after 1975.

However, in capitalist states the official ideology has, at times, also lost much of its influence, as occurred during the Great Depression of the 1930s when capitalism seemed to be failing. Again, in 2008 the sudden financial and economic collapse in the advanced countries led to widespread questioning of the dominant free-market ideology. However, in neither case did system collapse follow. Gorbachev tried to renovate the official ideology of the Soviet system while also seeking to jettison the features of the Soviet system that were in conflict with socialist ideals – yet that effort did not succeed. One has to ask why it did not.

Some analysts attribute the Soviet demise to the costs to the Soviet economy of keeping up with Western military spending, claiming that such costs led to the Soviet economic slowdown after

1975 that ultimately undermined the USSR. However, the evidence about Soviet military spending does not support this explanation. In 1950 Soviet military spending absorbed about 17 per cent of GNP, a much larger share than for the USA. However, while military spending rose during 1950–80, it rose more slowly than GNP, falling slightly to 16 per cent of GNP in 1980 (Ofer, 1987). Since the military burden did not prevent rapid economic growth during the 1950s and 1960s, it is not plausible that it could explain a growth slowdown in the mid-1970s. Under Gorbachev military spending was reduced as a share of GNP as relations with the USA improved.

An influential explanation is that nationalism destroyed the Soviet system. According to this view, once political repression was lifted and the system was liberalized under *perestroika*, the drive for independence of the various nationalities that made up the USSR could not be contained. Nationalist movements of growing strength did arise in some of the Soviet republics in the late 1980s, and the final collapse of the USSR did take the form of the dissolution of the Union into the 15 republics that had constituted the USSR. However, there are two serious weaknesses in this explanation for the Soviet demise.

First, while nationalism might be able to account for the disintegration of the Soviet state, it cannot explain why the social system was changed from state socialism to capitalism. While some other states disintegrated in this period (the GDR and Czechoslovakia), most did not. Second, a careful analysis of the political process in the USSR during 1989–91 does not support the claim that a drive for independence stemming from nationalism explains the Soviet demise. In a referendum in March 1991, held in 9 of the 15 republics representing 92.7 per cent of the Soviet population, 76.4 per cent supported preservation of the Soviet Union. It was the determination of the group led by Boris Yeltsin to attain state power that led to the disintegration of the USSR, not nationalist pressures. Yeltsin was unable to push aside Gorbachev and his backers in the largely democratic new Soviet governing institutions created in 1989. Instead, Yeltsin had to shift to a strategy of taking power in the Russian Republic of the USSR, from which position he was able to dismantle the USSR.<sup>3</sup>

The key event was Yeltsin's success in getting the Russian parliament to pass a sovereignty resolution on June 8 1990. This asserted that control over Russia's vast natural resources, previously provided to the whole USSR at subsidized prices, belonged to the Russian government, not the Union state. While this could not be enforced yet, its passage propelled the other 14 republics on the road toward leaving the USSR, including the majority that had previously had no significant nationalist movement. In August 1991 Yeltsin seized the power that would soon enable him to dismantle the USSR when, following the failure of a coup attempt by members of Gorbachev's cabinet, Yeltsin, without any legal basis, shifted control over all Soviet assets in the Russian Republic to that republic's government and banned the Communist Party on Russian territory, causing the other republics to flee the Union.<sup>4</sup>

Another explanation claims that popular opposition to socialism and support for capitalism overthrew the system. According to this view, once Gorbachev's *perestroika* instituted free elections and the right to engage in political activity, the majority voted in capitalism by voting for Boris Yeltsin, at least in the Russian Republic where Yeltsin won the republic presidency with 57.3 per cent of the votes in June 1991. However, Yeltsin never stated that he favoured capitalism. He campaigned for office stressing opposition to the privileges of the elite and support for democracy, 'market reform', and more rights for the Russian Republic within the USSR. Some introduction of markets was part of Gorbachev's plan for the reform of Soviet socialism. Public opinion surveys showed that a majority of the Soviet population continued to support some form of socialism through 1991, with only between 3 per cent and 17 per cent supporting the introduction of capitalism, depending on the wording of the particular survey (Kotz and Weir, 2007, pp. 132–34). While Yeltsin did become popular with most sections of

the Russian Republic population in 1989–91, the public never endorsed the introduction of capitalism or the dismantling of the USSR.

Many analysts argue that the Soviet demise was owing to accidental developments rather than any systemic factor. There are two main variants of this explanation. The first is the ‘Andropov’s kidney’ explanation – that Yuri Andropov, the first post-Brezhnev General Secretary and a tough and practical former KGB head, would have been able to maintain the system through modest reforms had his rule not been cut short by him dying of kidney failure after 15 months in office in February 1984. According to this view, it was Gorbachev’s impetuous, ill-thought-out transformation of every aspect of the Soviet system within a very short period that produced a cascade of unforeseen consequences that rapidly destabilized the system (Ellman and Kontorovich, 1998). While it is difficult to deny that Gorbachev conducted the reform in ways that unexpectedly caused serious economic problems and that enabled the groups favoring capitalism to come to power, the fact that a similar transition occurred in almost all of the other Communist-ruled states strongly suggests that some systemic factor was at work, making this explanation unpersuasive.

A second version of this explanation, popular among supporters of the pre-*perestroika* Soviet system and among some analysts in China, holds that Gorbachev had a secret plan from the beginning to dismantle socialism, which he was finally able to carry out once he became the General Secretary. There is no evidence to support this view of Gorbachev, apart from a supposed claim that has circulated on the internet since the early 1990s in which Gorbachev is quoted from a media interview as admitting that he had wanted to destroy socialism, the Communist Party, and the USSR from the beginning (with his wife and Western powers influencing his decision) – a quote which Gorbachev has several times stated is a fake. In any event, if a single individual could destroy the Soviet system by reaching the top of the political hierarchy, that implies a serious systemic weakness in that system, which must be explained.

### Explaining the Soviet demise

The explanation that seems to fit the historical process in the USSR during 1985–91 is based on a contradiction in state socialism that was present from the start and whose effects intensified over time as the system evolved. That is the contradiction between a system designed to deliver economic benefits to the population on the one hand and the control of that system by a small self-perpetuating élite on the other. The Soviet system was built by socialist revolutionaries seeking to replace capitalism, which they saw as based on the exploitation of labour by a small wealthy class, by a system of production designed to meet the needs of the producers. All the major means of production were state owned, and production was guided by an economic plan that was supposed to be aimed at meeting individual and social needs. The system provided the population with full employment, almost guaranteed lifetime jobs, guaranteed pensions, free education and medical care, inexpensive vacations, and subsidized housing.

However, the system was, from the beginning, run by a small and self-perpetuating ‘party-state élite’, with power flowing from the top down rather than from the bottom up. The elite ruled in a dictatorial and repressive manner. Before the Russian Revolution all socialists had expected that socialism would be democratic, more so than was possible under capitalism with its small class of wealthy owners of the means of production. However, that is not the way it turned out.

This contradiction meant that the group that held a monopoly on power – the officials who ran the system – had no collective or individual interest in maintaining the system. The founding generation of leaders were committed to what they thought of as socialism. However, over time, as the founding generation was replaced by individuals who had risen within the

system, the ruling elite changed from a group of dedicated revolutionaries to a group consisting primarily of people seeking power and privilege. The successor generations of high officials learned to mouth the official socialist ideology, but studies of the Soviet élite in the 1980s show that only a few actually took it seriously.

The Soviet elite was a materially privileged group. Its members had exclusive access to the best housing and consumer goods. However, the material privileges of the ruling elite were restricted by the socialist features of the system. Members of the élite could not legally own any property, beyond a home and an automobile. Most of their privileges were attached to their position in the hierarchy, not their person as is the case in capitalist systems. While they could use their connections to get their children into the best schools and then into comfortable jobs, they could not pass on any significant wealth to their children or even assure them entry into the ruling élite.<sup>5</sup> Even accounting for the special perks of members of the Soviet élite, their consumption level was far below that of high level officials in Western capitalist systems, both absolutely and relative to the average consumption level of the society. The official incomes of the highest paid members of the elite were only about eight times that of the average worker – far from equality but even farther from the huge multiple found in capitalist systems.<sup>6</sup>

Because of the very hierarchical structure of the élite of the state socialist system, with power concentrated in the top leader or a small group of top leaders, there was no opportunity for members of the elite to openly question the system. However, as the system evolved, the basic contradiction between a privileged, self-perpetuating élite and a system that provided no legitimacy for their privileges – and indeed served to limit them – was bound to eventually undermine the elite's support for the system. Once Gorbachev's *perestroika* democratized the system, it freed the party-state elite to ponder the future of the system.

Few members of the élite found Gorbachev's vision of a democratized socialism appealing – it was likely to reduce the élite's privileges and power. Few found a return to the pre-*perestroika* system attractive, since it was that system that had limited their privileges. Capitalism soon emerged as the most appealing future to a majority of the party-state élite.<sup>7</sup> That direction of change would position them to shift from the managers of the valuable assets of the Soviet system to becoming the owners.<sup>8</sup> Once a large majority of the ruling elite turned against the existing system and came out in support of capitalism, they constituted a powerful force for transition.<sup>9</sup>

By 1991 most of the party-state élite had shifted their allegiance to Boris Yeltsin, who, despite his refusal to state publicly that he favored capitalism, clearly signaled to the sophisticated that a transition to capitalism was exactly his aim. Yeltsin's success at winning support from the great majority of the party-state élite was the key to his rise to power in the Russian Republic. In 1990 he was narrowly elected chairman of the new Russian Republic parliament – making him the chief executive of that republic – only by winning support from a large part of the Communist Party deputies. His top advisors and inner circle were made up, not of dissident democrats, but of people from the Soviet élite who were rejecting Gorbachev's plan for the reform of socialism (Kotz and Weir, 2007, p. 131). While, as was noted above, the majority of the Soviet public continued to favour some form of socialism, the Soviet system had bred passivity into the population, and the outcome was decided by struggles within the elite (Kotz and Weir, 2007, Ch. 8).

This explanation of the demise of the Soviet system accounts for its rapid and relatively violence-free character. Once a large majority of the élite, which had run the USSR since the 1920s, decisively threw its support behind a shift to capitalism, it was very difficult to stop the transition. As Soviet expert Jerry Hough has noted, Gorbachev, who officially retained control of the coercive apparatus of the state to the end, could have ordered Yeltsin's arrest for violation of Soviet laws, but he never did so (Hough, 1997, Ch.10). Gorbachev's method of political operation had always been manoeuvre within the elite, and once he lost its support, he seemed to give up.

## Implications of the reasons for the Soviet demise

The way in which the demise of the state socialist system and the shift to building capitalism took place in the Soviet case differed in various respects from the other cases of transition. However, the same underlying contradiction was operating in all of them.<sup>10</sup> In some countries in East/Central Europe, a powerful opposition movement arose outside the Communist Party in the late 1980s, but in most cases the Party gave up power without much if any resistance. In Poland and Hungary, successor parties to the Communist Party soon emerged as able managers of the transition to capitalism, with their original base in the former state socialist élite enthusiastically supporting the transition.<sup>11</sup>

China has followed a different path of transition since 1978, yet it has been driven by the same underlying dynamics. In China the Communist Party has held onto power while supervising a gradual transition to a market economy with predominantly private ownership of enterprises. China's élite has been enriched by this process, and many of the wealthiest new capitalists are connected, by blood or other ties, to party officials. In 2002 the party changed its rules to admit 'entrepreneurs', meaning capitalists, to membership in the party. While this process is officially described as 'socialism with Chinese characteristics', few believe this characterization, with most observers viewing it as 'capitalism with Chinese characteristics'.<sup>12</sup>

The Cuban leadership's resistance to a transition to capitalism, despite its weak economy and enormous pressure from the USA, can be explained by the continuing presence in power of the founding revolutionary generation, which has not given up on socialist ideals. It is likely that, once the founding generation passes from the scene, Cuba will follow some path to capitalism. However, such an outcome might not be uncontested, despite the serious economic difficulties in Cuba, since Cuba's version of state socialism, while sharing the feature of concentration of power in a few hands, has probably been the most successful one at engaging the population in active participation and winning active support in the population for socialist ideals.

The explanation for transition proposed here has implications for evaluating the advice on transition strategy given by Western institutions. Among the main reasons that most Western advisors recommended a rapid transition, including immediate liberalization and quick privatization, was the belief that the old Communist élite was liable to stage a return to the old system if given an opportunity. Many Western advisors thought it was necessary to 'make the transition irreversible' whatever the cost of rapid transition might be. This meant freeing prices in the face of huge excess money demand, which was bound to unleash a burst of rapid inflation that caused many problems. It meant quick privatization in societies having no legitimate wealthy class that could buy the privatizing enterprises, which had many negative results, including that in many cases well-connected individuals or criminal elements obtained the enterprises for next to nothing. Had the Western advisors better understood the process that led to transition, including the support for this process by most of the old élite, more consideration might have been given to a more gradual path of transition, which the case of China suggests can be far more effective.

## Notes

- 1 This chapter does not consider the case of Yugoslavia, despite the fact that a Communist Party held power there until the 1980s. Although the new states that emerged from the former Yugoslavia are often included in the list of transition countries, Yugoslavia adopted the Soviet model of state ownership and central planning only for a few short years in the late 1940s and soon shifted to a quite different system – a market system with worker managed enterprises. Thus, the 'transition' that occurred in Yugoslavia starting in the 1980s was not a transition from the Soviet model.



- 2 Claims that US Central Intelligence Agency estimates of Soviet economic growth rates were exaggerated arose after the Soviet demise, but no serious evidence was ever found to support such assertions. See Kotz and Weir (2007, pp. 37–39) and Millar *et al.* (1993).
- 3 The Russian Republic, one of 15 making up the USSR, had about half of the Soviet population and three-fourths of its land area. The official name for the Russian Republic was the Russian Soviet Federated Socialist Republic.
- 4 For a full analysis of these events, see Kotz and Weir (2007, Ch. 8).
- 5 One study found that, in the late 1970s 70 per cent of ministers and heads of state committees and over 50 per cent of the directors of the largest state enterprises began as workers or peasants (Kotz and Weir, 2007, p. 309 note 71).
- 6 For evidence about the limited material privileges of the Soviet elite, see Kotz and Weir (2007, pp. 106–10) and Hough (1991, pp. 276–77).
- 7 A focus group survey of a sample of the Moscow elite in June 1991 found 76.7 per cent to have a pro-capitalist ideology, while 12.3 per cent favoured democratic socialism and 9.6 per cent the old regime (Kotz and Weir, 2007, pp. 110–11).
- 8 One study found that 62 per cent of the 100 top post-Soviet Russian businessmen in 1992–93 were from the Soviet party-state elite (Kotz and Weir, 2007, pp. 113–14). For an account of the transformation of members of the Soviet party-state elite into capitalists, see Kotz and Weir (2007, pp. 111–21).
- 9 A full account of the transition to capitalism in the USSR is more complex, in that other groups in Soviet society became important supporters of transition to capitalism, including much of the intelligentsia, many of the most influential economists, and a newly emerging class of capitalist owners of enterprises. However, the elite played the decisive role (Kotz and Weir, 2007, Chs 5–7).
- 10 In addition, Gorbachev's decision to announce a non-interventionist policy in other Communist Party ruled states made it possible for transition to occur in East/Central Europe.
- 11 The demise of state socialism followed a somewhat different path in the GDR, where a democratic reformist group inside the Communist Party pushed the old party leadership aside at the last moment. However, the new reformist leadership lost the support of the majority of the population, who voted for merger with the Federal Republic, lured by the prospect of the West German consumer lifestyle.
- 12 In 2006 the author asked a provincial party official, who was talking about the many Western investments in the area, what made China 'socialist'. After a few minutes of puzzled silence, she replied, 'The government does things that benefit the people.'

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