

3. The Largest Historical Event: The End of Soviet Socialism

An economic system of public ownership to the means of production is Socialism. In combination with central planning, it is Soviet socialism. It was the economic system in 15 countries before 1988.¹ The system collapsed 1988-91 in 10 of these countries, and as shown in Table 1 this resulted in 28-29 countries. This is by far the biggest event in the period since 1960, and it has influenced many other countries. In the perspective of the book, Soviet socialism is the story of a large detour from the path of the Grand Transition that finished by a set of exogenous triggering events, which caused the 10 countries, their successors and many others to move toward the transition path.² The chapter concentrates on this story.

The five sections of Chapter 3 give an overview of the events and explains why they are exogenous. Section (s1) describes the amazing difference in the performance of the Soviet and the Western systems. Next follows a brief survey (s2) of the change of the economic and political systems, where six Muslim countries follow a different path (s3). The events in Russia were complex, unexpected and unique, and hence practically exogenous. They were an external chock in the rest of the Soviet bloc (s4) and in many other countries (s5).

3.1 *Soviet socialism: It did matter*

Table 1 lists the 10 countries with the Soviet system, at the start of our data, where the system collapsed. It resulted in 29 successor states. Cuba and North Korea still have Soviet socialism, while China and Vietnam and perhaps Laos have moved out of socialism by a more gradual avenue. The crucial trait in the Soviet socialism model was that it only relied on markets in marginal ways. Instead, it used central planning and administrative allocation of the main goods. This required a totalitarian dictatorship that is a large cost of the system. This empirical fact has a number of explanations going back to Schumpeter and Hayek.³

¹ A large literature describes Soviet socialism – in particular see Nove (1977). Another large literature discusses the change out of socialism; see Gross and Steinherr (2009) and Paldam (2002b), which runs to 319 pages. This effort should permit me to be dogmatically short at present.

² In the literature on the change from socialism, it is often termed a transition. This is not how the term is used in this book, as there is no steady state in either end of the change in the countries involved.

³ All political systems need to take popular and unpopular decisions. In a market economy, the political system takes most of the popular decisions, while most unpopular ones are left to the market. In a socialist system, the political system takes all decisions, hence public debates and interest groups have to be controlled. Political parties often promise too much before elections. Think of a situation where all decisions are political.

Table 1. The 10 countries with Soviet socialism until 1989/90 and the 28-29 successor states

Socialist	Post-socialist	Socialist	Post-socialist
Soviet Union/new countries		Soviet Bloc/mostly old countries	
USSR	1. Armenia	Bulgaria	Bulgaria
	2. Azerbaijan	Czechoslovakia	1. Czech R.
	3. Belarus	breaks up 1992	2. Slovak R.
	4. Estonia	East Germany	Part of Germany
	5. Georgia	Poland	Poland
	6. Kazakhstan	Hungary	Hungary
	7. Kyrgyzstan	Mongolia	Mongolia
	8. Latvia	Romania	Romania
	9. Lithuania	Other socialist/mostly new countries	
	10. Moldova	Albania	Albania
	11. Russia	Yugoslavia	1. Bosnia
	12. Tajikistan		2. Croatia
	13. Turkmenistan		3. Macedonia
	14. Ukraine		4. Montenegro
	15. Uzbekistan		5. Serbia
	Seven areas with unclear status (a)		6. Slovenia
			7. Kosovo (b)

Notes: (a) Abkhazia, Nagorno-Karabakh, South Ossetia, Transnistria, Donetsk, Luhansk and Crimea. (b) Kosovo is an independent country, but it is not recognized by all countries. It has weak data. The 28-29 countries included in Figures 1 and 2 are all the post-socialist countries except Kosovo. The 28 countries are for 1990-91, but Czechoslovakia broke into two in 1992, which gives 29 countries. Serbia included Montenegro until 2006. Wars between Serbia, Croatia, Bosnia and Kosovo started in 1991 and continued to 1995-1999.

The Soviet model was very inefficient is illustrated by the twin-test of Table 2. It covers a number of cases where two parts of an old country, or two similar neighboring countries, have been under different systems. The degree of similarity falls from the start until the end of the table. The data have many measurement problems, so only crude assessments are reported, but the differences are large anyhow.

The capitalist twin has always done much better, both in the economic and political dimension (with one exception). In addition, the rates of accumulation as a fraction of GDP, were about twice as high in the socialist twin as in the capitalist one, but still they came to lag more and more behind. Obviously, Soviet socialism is an economic system with much lower efficiency.

I think that this inefficiency evidence is the strongest one supporting the Primacy-of-Institutions theory; see Chapter 1.11. The inefficiency of the Soviet economic system seems to have been due to the economic system – not to the totalitarian political system.

Table 2. Twins with different economic systems

Capitalist twin Name	Socialist twin Name	Established	Initial values		Duration Years	Resulting difference	
			<i>gdp</i> (a)	<i>Polity</i> (b)		<i>gdp</i> (a)	<i>Polity</i> (b)
South Korea	North Korea	1946	1.0	same (c)	60	0.1	-17 (2015)
West Germany	East Germany	1946	0.9	same (c)	44	0.3	-19 (1988)
Finland	Estonia (d)	1939/44	1.2	-10 (1940)	46	0.3	-16 (1988)
Austria	Czechoslovakia (e)	1946	0.8	-1 (1932)	44	0.3	-17 (1988)
Austria	Hungary (e)	1946	0.7	-9 (1932)	44	0.3	-12 (1988)
Chinese Tigers (f)	China	1948	0.6	differ	58	0.2	-12 (2003)
Finland	Russian SR	1918	1.1	-9 (1918)	72	0.3	-15 (1988)
Costa Rica	Nicaragua	1979	0.8	-18 (1978)	10	0.3	-11 (1990)
Dominican Rep.	Cuba	1960	1.2	0 (1959)	45	0.3	-15 (2015)

Notes: (a) The relative *gdp* of the socialist twin at the start and the end, measured as *gdp*-ratio of socialist twin to capitalist twin. (b) The *Polity* point difference measures how far behind in democracy the socialist twin was at the end. (c) Before foreign occupation. (d) Finland and Estonia have almost the same language and history from 1800 to 1939, where Estonia was forced to rejoin the USSR. (e) Austria, Hungary and Czechoslovakia were the central countries in the Habsburg Monarchy until 1918. (f) The Chinese Tigers are Taiwan, Hong Kong and Singapore. The first pair of twins is used as a smoking gun test in Acemoglu *et al.* (2005).

In a wider perspective, many have tried to compare Russia with the USA and Western Europe in the years 1913 and 1990. The index problem is large, but as far as the data goes, the difference has been fairly constant – the USSR did not manage to reduce the gap to the West, while a number of other countries have closed most of the gap.

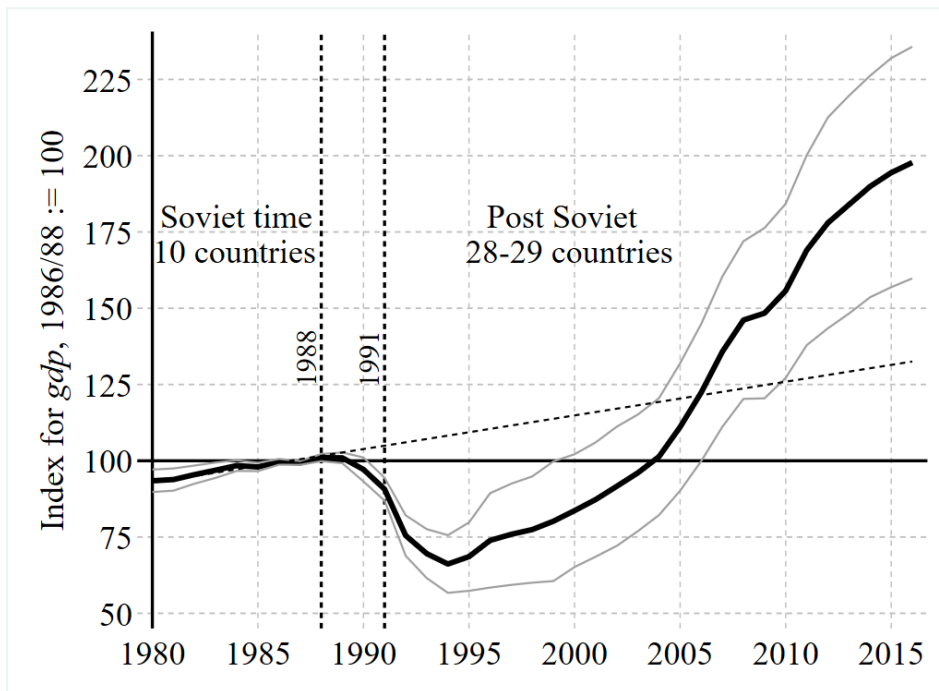
Finland was part of the Russian empire from 1809 to 1918. In 1918, when Finland became independent, the *gdp* of Russia was a little higher than the one of Finland. The USSR reported higher growth than Finland nearly every year from 1920 to 1990, but in 1990 Finland had a *gdp* that was much like other Western countries, while the *gdp* of Russia was about 1/3 of the one of Finland. In addition, the costs in human sufferings in Russia were much larger than the social costs of development under capitalism.

3.2 *The change from the Soviet model – big costs and a long lag*

The change from socialism in the 10 countries (in Table 1) happened from 1988 to 93. The change was both in the economic and political system, and it greatly influenced economic development and all institutions.

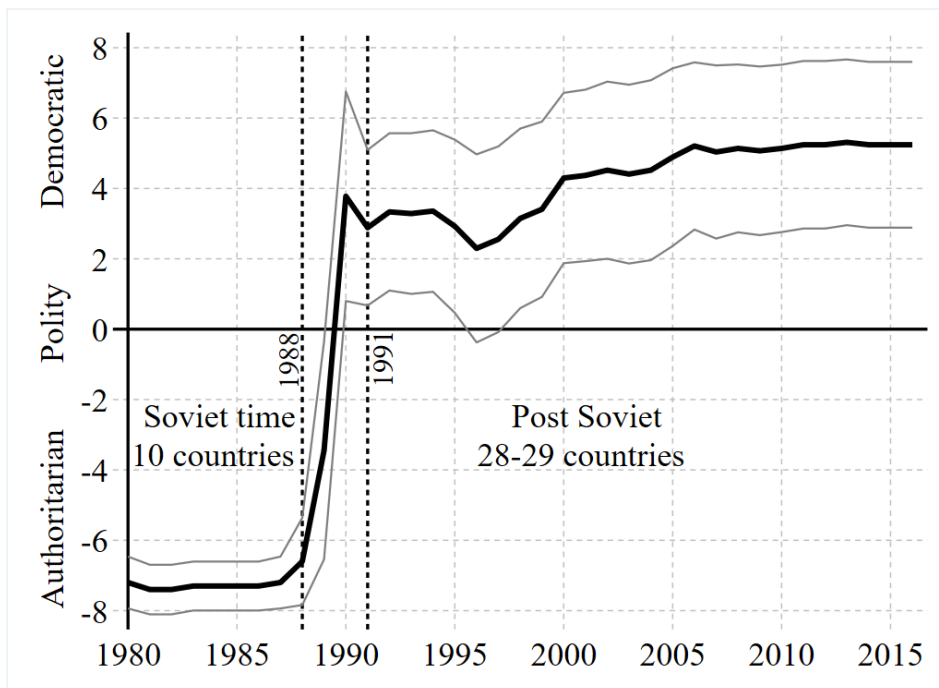
Figure 1 shows that the change caused an economic crisis in this country group that, at the bottom after 2-5 years, reached a fall in *gdp* of about 40%. It led to a rebuilding boom, and most post-socialist countries are now wealthier than they would have been without the change. Thus, there have been *short-run costs* and *long-run benefits*. This is a common result in studies of institutional reforms, but it surely had a large size in the case at hand.

Figure 1. The average path of the *gdp* in the countries from Table 1



The bold curve is the average of the *gdp* indices calculated so the average for the three years 1986-88 is set to 100. The gray lines are confidence intervals (gray lines) at two standard errors. The downturn caused by the system change bottomed out at a *gdp*-loss of 40%. The path reached 100 once again in 2004. It overtook the old path (dashed line) already two years later. The loss suffered (the sum of the losses below the dashed line) will be recovered (as a similar sum of gains above the line) in 2020/22.

Figure 2. The average path of the Polity-Index in the countries listed in Table 1



Some countries have no observations in some of the years between 1988 and 1991. The large rise in *P* during the change from socialism did cause some cyclicity, but not as much as is normal.

The story of the collapse and the reforms leading to the new development differ from one country to the next. Things went fastest in countries that were closest to the West, and managed to create national unity around a fast reform process – known as chock therapy.

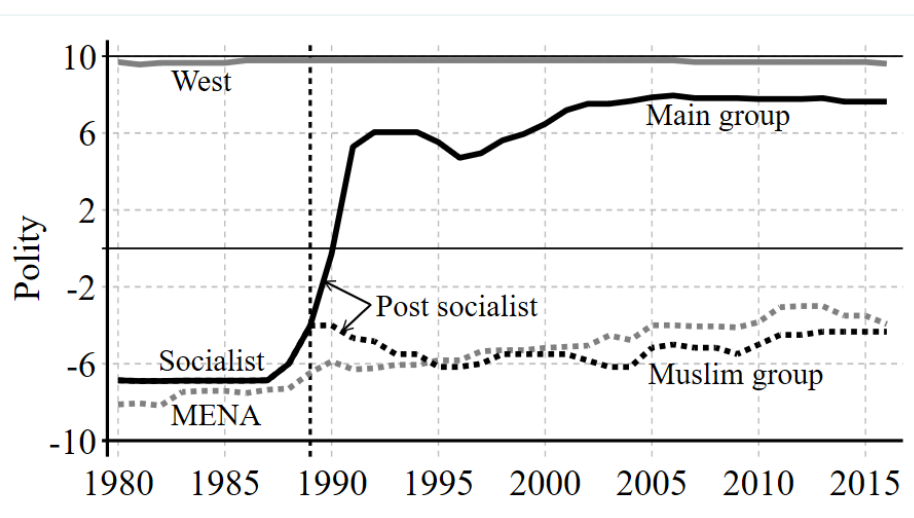
Figure 2 shows the same average curve for the Polity index. Here a big jump occurred toward democracy. The size of the jump is 10 *P*-points, which after a small cycle and a decade has consolidated at 12 *P*-points.

The pattern found becomes even clearer when the incomes of the countries are adjusted for. The richest countries – that are also the countries closest to the West – move to full democracy. The reader will know that several of the new countries – which have few democratic traditions (such as Hungary and Poland) – have found it difficult to consolidate the new institutions, and recently there has been some backlash.

3.3 *The exception of the Muslim/MENA countries*

Throughout the book a main exception is the OPEC/MENA countries.⁴ Six of the 28/29 new countries of the block, belong in the MENA group in the cultural sense, though only one is an oil country. However, the five central Asian countries are also relatively poor. Figure 3 show that they are indeed an exception.

Figure 3. The path of the polity index from Figure 2 divided in Main and Muslim group



The Muslim post-socialist sample consists of Azerbaijan, Kazakhstan, Kirgizstan, Tajikistan, Turkmenistan and Uzbekistan. I have included Albania in the main group due to the evidence of low religiosity in the country. Here the main group is the remaining 23 post-socialist countries. The West is also 23 countries.

⁴ MENA means Middle East and North Africa. Thus, it covers all Arab countries, Turkey and Iran. I exclude Israel from the group. Today Israel is a typical Western country.

While the main group of post-socialist countries is approaching the West, this is not the case for the six Muslim post-socialist countries. They rapidly moved to become typical MENA countries. The figure seems to argue that it is Islam more than oil that cause the OPEC exception. However, in other work I have found that both Islam and oil count (see Borooah and Paldam 2007). The rest of the book does speak of the OPEC exception, as it is the easiest to explain; see sections 1.8 and 4.8.

3.4 Causality

It is easy to argue that the collapse was *a ketchup effect*, which is a visual illustration of the Jumps Model in Chapter 5 – though the shakes of the bottle happen with lags of a random length. The economic and political systems of the Soviet bloc were doing badly compared with countries at the same level of development, and this created tensions. Gradually, tensions grew, and finally the system broke in a big way. However, it might have happened 15 years before or 15 years after, and it might have been a gradual process as in China and Vietnam. Chapter 6 tests the effect and demonstrates that increasing tension does not explain when systems break, but it does explain what happens when the triggering event occurs.

What happened in Russia was a very big version of a story that will return in subsequent chapters: First, a triggering event occurred, and then the country went toward the transition path, both as regards the economic and political system. The triggering events are:

- (i) A set of complex, unexpected and unique events in the center, i.e. Moscow.
- (ii) It caused the Russian grip on the rest of the socialist bloc to weaken, so that the change could spread through the bloc, and further to other socialist countries.
- (iii) It also caused a large wave of changes in perceptions and beliefs – which involve the mysterious concept: *zeitgeist*. Socialism went out of fashion in a big way.

A large literature exists about (i) the historical events in Moscow (Google has 14.3 million hits on the ‘collapse of Soviet socialism’). Factors in the explanation were the failed coup of the old guard, and the resulting weakening of the position of Gorbachev relative to his main rival Yeltsin,⁵ etc. Once the process of collapse started, the Communist Party crumbled, and the whole structure of the regime came tumbling down. Thus, the triggering event was a set of rather random political events. Chapter 1.11 termed such events *practically exogenous*.

⁵ During the coup attempt, Gorbachev was isolated in his vacation home at the Crimea, while Yeltsin was a main actor resisting the coup.

Compare with the events in Romania: The collapse of the USSR made a big impression on the Romanians, causing fears of the strongman Ceaușescu to vanish. In early December 1989, he suddenly faced large hostile demonstrations, and he then discovered that he could not command his troops to shoot at the demonstrators. This caused a rapid disintegration of the regime, and at the end of the month, the strongman was executed. Thus, the triggering event was an external event that had the character of an exogenous shock. The events in the remaining 26 countries are causally similar to the events in Romania, in the sense that they would not have happened without the events in Russia and the resulting wave of changes in perceptions and beliefs. While the trigger was the same, the process of changes it caused differed between countries, but a few years later the outcome was much the same. The events were greatly influenced by the difficulties of privatization that led to periods of unclear property rights, allowing large-scale rent-grabs, where a small number of bold entrepreneurs suddenly became oligarchs.

As regards the swings in the zeitgeist, history has seen a number of large swings in opinions and beliefs that happened internationally. It is hard to provide rational explanations for such swings. The revolutionary years 1830, 1848 and 1918 were rather international. Often the ideas spread from students to trade unions, but in small towns far from universities, they may appear as a small ripple. However, they do influence politics.

Our period since 1960 experienced a wave of utopian socialism in the West in the late 1960s and for the next 3-5 years. It was probably inspired by the Cultural Revolution in China in 1966, and started at the universities in California and Paris in 1968, and then rapidly spread. With a few years' delay, it was one of the factors pushing socialism in the LDC-world. It also led to a wave of extremism that caused terrorist movements in several Western countries and in countries far away. It peaked in China after 6-8 years of Cultural evolution, and it became even more extreme in Cambodia, where the government tried to exterminate the ideas and beliefs of the old system by mass murder, 1975-78.

In the late 1980s, an opposite wave against socialism and for privatization and other market reforms took place, as already mentioned. Though it is often possible to find an initial reason for these movements, it is also clear that they have an inner dynamics that may make them much larger than the initial reason justifies. Moreover, they do have a large international element and come in cycles.

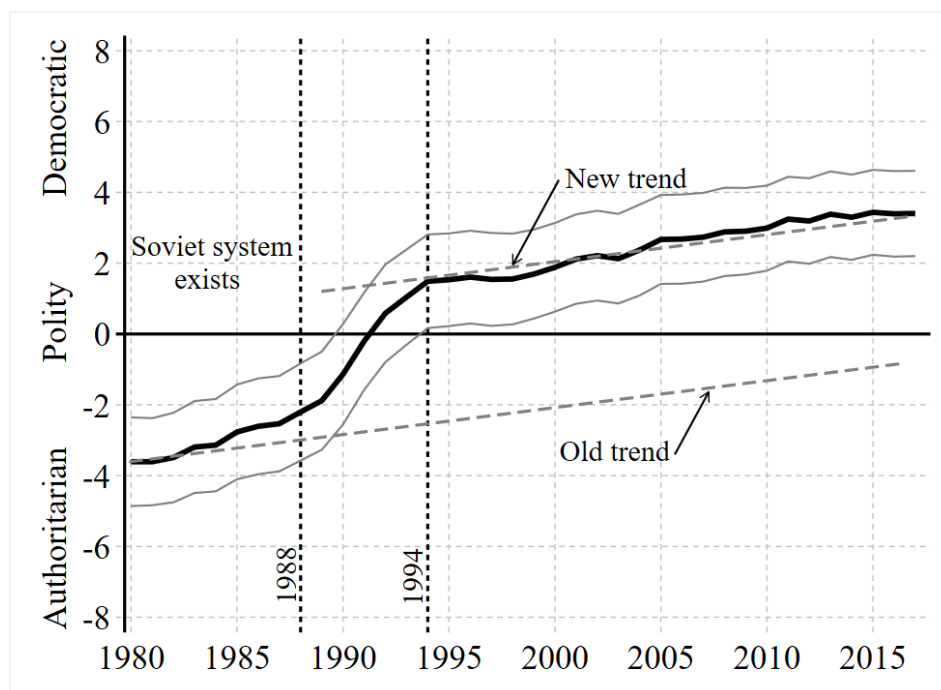
3.5 *The effects on the rest of the world*

In addition to all the countries in the Soviet Bloc, the wave of changes hit Albania and

Yugoslavia that were socialist countries outside the Bloc.

Figure 4 looks at the average for the 94 countries that are neither post-socialist, nor Western nor OPEC countries, and have data for all years from 1985 to 2016. It is drawn on the same scale as Figure 2 for an easy comparison. There is more of a trend in these data than in the ones of Figure 2, but it is clear that there is a shift in the trend of about four *P*-points, which is 1/3 of the change in the post-socialist countries on Figure 2. In addition, the change on Figure 4 takes twice as long.

Figure 4. The effect of the collapse of the Soviet model on 94 other countries



Average of all countries with complete data, which are neither post-socialist, nor Western nor OPEC.

In some countries, the change was quite dramatic: An example is Congo Br that was the Democratic People's Republic of the Congo, which was ruled by the Marxist-Leninist party. In 1990, the ideology and many policies changed quickly. Other political parties were allowed, and a free election took place in 1991. A similar story happened in Nicaragua, which was a one-party socialist state ruled by the Sandinista party. It allowed free elections in 1990, which the Sandinistas lost to a democratic coalition.