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ENTREPRENEURSHIP AND THE TRANSITION FROM SOCIALISM TO A FREE MARKET ECONOMY*

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Introduction

Entrepreneurship and its significant role on economic growth has always been stressed by economists. The issue being discussed in the present article is the necessity of introducing entrepreneurship in the former socialist countries. In the first section the crucial entrepreneurial function and the main characteristics of the entrepreneur will be presented. In the second section, some weaknesses of the former Soviet-economy which could be attributed to the absence of entrepreneurship, will be analyzed. In the third section some propositions will be put forward and some problems will be investigated regarding the introduction and infusion of entrepreneurship in those economies which are intending to change their socialist economic system to a mixed capitalistic economic system.

I. Entrepreneurship: function and characteristics

Although a variety of entrepreneurial theories were developed in the past (see Karayiannis, 1990, pp.247-255; 1992a, pp.67-93), in our day the following seem to be the most prevailing in terms of their explanation and of justification power.

On one hand, there are theories which emphasize the "active" role of the entrepreneur. First, there is the Schumpeterian theory of innovation. According to Schumpeter, the entrepreneur acts upon the recognition of profit opportunity open to him (1934, p.88) by adopting the following innovative activity: he creates new products, opens or discovers new markets, uses a more productive process and organizes the enterprise more efficiently (1934, pp.132-6). Second, we have the Neo-Austrian theory developed by Kirzner where the entrepreneur is "created by the state of disequilibrium and his activities ensure a tendency toward equilibrium" (1979, p.III). Kirzner (1973, pp.66,73) emphasizes the crucial entrepreneurial function of the "arbitrageur" who, discovering discrepancies in market prices, exploits the unnoticed profit opportunity. Third, is the theory, developed by Schultz and Casson, of the reallocation and coordination of scarce resources (Schultz, 1980, pp.443, 449) by taking judgmental decisions (Casson, 1982, p.23). Fourth, is the "synthetic" view, according to which an entrepreneurial theory must be built upon the connection of the previous major three theories, as they are not mutually exclusive (Karayiannis, 1990, pp.259-262; Kaiser, 1990, pp.9,17).

On the other hand, there is the "passive" function of the entrepreneur in bearing the risk of uncertainty developed in different epochs by Cantillon (1755), Hamil (1876) and Knight (1921) (see Karayiannis, 1992b). This passive function of bearing

Page 42

the risk of uncertainty as a symptom of the dynamic economy and the function of entrepreneurs (Karayiannis, 1987, p.619) accompanies, more or less, the entrepreneurial function as has been described by the above mentioned "active" theories.

The entrepreneur, having "the first idea", is activated in one way or another into producing, generally speaking, some significant positive effects in the economy: he

increases the production possibility curve or changes its slope, creates new products, helps the economy to reach equilibrium (in conjunction with other equilibrium factors), minimizes its x-inefficiency, etc. The entrepreneur, in accomplishing all those economic benefits, has to be rewarded and his reward is not only pecuniary (i.e. his profit), but also non-pecuniary by gaining a freedom of control by others, and the sense of "doing one's own thing" (Ronen, 1983, p. 140).

The dual interaction between the various material and non-material incentives and the accomplishment of entrepreneurial function, presupposes a cultural and economic environment which will strengthen this interrelationship. In Western countries empirical investigations have shown that the rate of entrepreneurship depends not only on the personal characteristics of the entrepreneurs but also on the "signals" of society. More specifically, a culture which stresses individuality, human autonomy and the heroic aspects of leadership, encourage entrepreneurship (Casson, 1987, p.152). Furthermore, it has been shown that entrepreneurs share some common characteristics. McClelland (1961) has pointed out that among the psychological drives that motivate the entrepreneur there is a high need for achievement (n Ach). McClelland as Brockhaus (1982, p.41) summarizes "characterized individuals with high n Ach as those preferring to be personally responsible for solving problems, for setting goals, and for reaching these goals by their own efforts. Such persons also have a strong desire to know how well they are accomplished their tasks. On the basis of these demonstrated characteristics, McClelland suggested that entrepreneurs should have high n Ach." In addition, McClelland (1961) "determined that persons with high n Ach have moderate risk-taking propensities" (Brockhaus, 1982, p.45).

Recent studies of the characteristics of entrepreneurs suggest that beyond the need for achievement, some other elements, such as a locus-of-control beliefs,¹ risk-taking propensity and personal values characterize the entrepreneur (Brockhaus, 1982, p.39).

The general economic environment in which the entrepreneur in the West operates is that of a free market economy with moderate state intervention. In this environment, besides some negative effects which are produced (i.e. oligopolistic market exploitation, unemployment, etc.), the spirit of competition, the economic and political freedom, and the mechanism of incentives have led to a high rate of economic growth.

Page 43

Let us see now, after this brief analysis of the function and the personal characteristics of entrepreneurs in the Western world, how this function has been substituted in the former Soviet Union and what the consequences are.

II. Absence of entrepreneurship

The recent economic crises in the former socialist countries produced mainly by the increasing bureaucracy and the constraint behavior of decision-makers as has been developed in the previous 70 years period through the 'devotion to the central plan'. The economist and academician Oleg Bogomolov wrote three years before:

"A widening gap between East and West in the progress of technology, productivity of labour, living standards of the population, inflation, permanent shortages of many first-need goods, non-competitiveness of the majority of the manufactures, drop of the economic growth rates, ever more cumbersome character of the part-and-state bureaucratic machine, a humiliated and dependent role of an individual in the society - these are the most characteristic symptoms of the ongoing crisis [in USSR]." (1989,

p.234; brackets added).

In the Soviet type economy the role and function of entrepreneur has been substituted by the "central plan" and the executives of it, that is, the managers. The Soviet leaders scheduled an economic system controlled from above and functioned through bureaucratic directions and controls. In "coordinating and directing enterprises bureaucratically through the extensive use of obligatory physical targets" (Bergson, 1983a, p. 191) they put much emphasis on human obedience to the will and the targets of the plan, and in extension, to the members of Politburo. They considered that obedience to an economic schedule could replace some material and other incentives necessary to the managers and workers for the achievement of high productivity, high quality of goods, and so on. However, as experience shown this was not enough to check the present economic crisis. The failure of the central planning system is partly attributed to the imperfect substitution of entrepreneurs by managers. Let us now proceed to the causes and consequences of this imperfection:

First, the *limited freedom in decision-making*: The managers who had to work with a technical-industrial-financial plan dictated from above and facing continual pressure from bureaucracy, proved reluctant to take fundamental decisions to modernize their firms. Moreover, the majority of managers - well educated in the field of engineering (Gregory & Stuart, 1981, p.183) - were appointed to their places not on the ground of their abilities in directing an enterprise, but more in accordance with their obedience to the "laws of the party". The selected managers were also obliged to work in an environment of restricted freedom in decision-making process, and thus their special qualities (if there were any) were prevented to emerge. Therefore, the mechanism for selecting the managers, which could have ensured that those with entrepreneurial talents would become the leaders of the enterprises, proved ineffective.

Page 44

Second, *inadequate incentives*: The lack of strong material incentives and economic freedom for Soviet managers was recognized in the post-Stalin period by Soviet leaders⁴ and economists as the main cause for the reduction of productivity. However, the material incentive fund that was created in enterprises and the bonus given to the managers in using new technology was not enough to promote innovations and to increase the productivity of enterprises.

Third, a high degree of *risk-taking aversion*: The limited economic freedom shared by the managers - restricted by the government and the banks - and the minor material and other incentives made them unwilling to proceed in risk taking activities. The managers in the former Soviet Union, taking the place of the Western entrepreneurs, were unable to increase the rate of innovation in the economy in the same time that the Western entrepreneurs were making large steps in that direction. The cause of the slow rate of technological and other innovation can be fairly attributed to the high risk aversion of the managers and the bureaucrats in the Soviet economy (Levine, 1983, p.250-1).⁸

Fourth, the *absence of competition* among the Soviet firms was another cause of the slow rate of innovation and the diffusion of new technology (Levine, 1983, pp.254-5). This weakness of the Soviet economy, which has as a result the low quality of consumers goods and their inadequate supply was recognized by former President Gorbachev who emphasized the necessity of increasing competition among the state firms and collectives in order to satisfy consumption needs (Perestroika, 1987, pp.146-162).

Fifth, the *slow rate of innovation*: Because of the above weaknesses of the managerial

system in directing the state and cooperative enterprises, the slow rate of innovation (mainly in the consumption goods) and its centrally planned direction toward defense equipment was the most profound characteristic of the Soviet economy. As Nove noticed: "Innovation suffered from lack of any built-in incentive to innovate" (1972, p.338). Moreover, the lack of appropriate motivation for innovation at the enterprise level proved inimical to technological progress (Grossman, 1966, PP-121-2).⁹

Sixth, *Information and knowledge*: As the information process had no optimum channel among the managers of different enterprises, disequilibrium emerged in the economy which caused the appearance of a second economy, particularly in the consumption goods. As the Soviet managers did not take decisions in an environment in which the firm had to automatically respond, without delay, to changing prices, technology and so on, they had to wait on centralized directives and thus their equilibrating role (if any) was eliminated.

Most of the above weaknesses of the Soviet economy, were obvious to the Soviet leaders and economists. The members of the Politburo, in order to eliminate part of

Page 45

those weaknesses, carried out two reforms: those of 1965 and 1987. In the first reform the government, in order to increase the economic freedom of the managers, reduced the number of the basic economic indices which was assigned "from above" to enterprises (Kosygin, 1972, pp.319-321). Moreover, the managers were stimulated "to pay greater attention to the quality of goods they produce" (ibid, p.319). In June 1987 former President Mikhail Gorbachev, recognizing the lack of incentives and competitiveness in enterprise level in the Soviet economy as one of its main causes for its economic crises (Perestroika, 1987, pp.142,145-6), suggested a reform which would start from below, i.e. from the enterprise level and not from above, i.e. the government (ibid, p. 144) and which would give more freedom to the managers of enterprises in their decision-making process (ibid., p.143). He originated this reform - whose fruits were gathered rather in political than economic level - into the main lines of the Soviet system, without disturbing the planned Soviet economy and its institutional bases (ibid., p.147). The Academician Aganbegyan in describing the Gorbachev's reform mentions:

"We are only at the very beginning of the transitional period from an administrative system of management to a mechanism emphasizing economic methods of management. A big step forward to this direction is the formation of a developed market" (1989, p.4).

Though in the few years from 1987 some state-owned and cooperative enterprises "transformed radically in the competition for domestic and export markets" (Bognar, 1989, p.7), and the amount of joint venture with foreign firms increased (Aganbegyan, 1989, pp.2, 7), the absence of a free market and entrepreneurship remained the main obstacles to "radical reform". However, the reforms that have taken place had small success, not only of the minor nature of the reforms but also because of the government's conservatism and the active and passive resistance of the old managers (Bognar, 1989, p.5; Baeck, 1991, p.614).

Because of the above weaknesses the former Soviet system has not been able to substitute entrepreneurs by managers. What they have to do is either to eliminate those weaknesses and to keep the role of managers as the most fundamental in their economy, or to move forward to a free market system by introducing and establishing entrepreneurship and restricting the role of managers to the large companies and those which are strategic for the economic and military independence of the former USSR.

The first or the second solution has to incorporate an increase of incentives and economic freedom which, however, are not sufficiently exercised in the absence of private property and economic freedom. Or to put it differently, entrepreneurship cannot be activated in the case where: (a) there are not efficient material and non-material motives; and (b) there is no freedom in exercising this activity (Ka-rayiannis, 1987, p.256, ft.64). Therefore, for the introduction and establishment of entrepreneurship drastic institutional and other arrangements have to be made in regard to: privatization (Baeck, 1991, p.618); decentralization of the decision-making process; expansion of the role of prices as an information conduct (Petr, 1990, p.5);

Page 46

reduction of the state's regulation and control; and the establishment of a more efficient money and credit system.¹

11

III. Introduction and diffusion of entrepreneurship: some propositions and problems

If the economic and political freedom is to be established in the socialist countries, then the introduction and diffusion of "socially activated entrepreneurs", to use the term of Houmanidis (1988, pp.366-7), are of primary importance. However, things are not so simple when introducing this factor of production. Most of the difficulties associated with the introduction of entrepreneurship are those accrued from the past and the present institutional situation of the former socialist economies. Thus we are proposing now some views under the above mentioned prerequisites, such as privatization, decentralization, etc. for the introduction, establishment and the diffusion of entrepreneurship in the socialist countries and present some significant problems and difficulties which might accompany them.

First, a strong anti-motive in the introduction of entrepreneurship is the past -before and after the revolution - state of entrepreneurship in Russia. As Kaser has put it: "Regulation has been the substitute for entrepreneurship in Russia during the thousand years of its recorded economic history, and in the past five decades regulation has eliminated entrepreneurship altogether" (Kaser, 1978, p.416).

Second, a long time hegemony of dogmatism against entrepreneurship during the Soviet regime has filled the minds of people who lived in a paternalistic environment with a neutral attitude and this has to be changed. The individuals and particularly the managers have to learn to react by pursuing their material self-interest. To put it differently, individuals have to learn that in order to improve their material life they must count more on their own powers and not on the states. However, to infuse young people with a high rate of achievements and to increase their responsibility and self-belief it is not a short-run target.¹⁴

Third, there must be scheduled an institutional and ethical entrepreneurial environment which does not permit dishonesty, fraud, etc. A major factor, which will create some problems in the transition from socialism to a free market system, is the establishment of a "fair" entrepreneurial code relevant to the working of the free market economy. In order to be increased, the entrepreneurial spirit in the former USSR the permission to work in these countries must be given to foreign entrepreneurs. Also, the introduction of new managerial techniques and other innovations, as Russia had done at the end of the 19th and the beginning of the 20th century,¹⁵ could be beneficial.

Fourth, the new entrepreneurs in the former Soviet countries have to search for profit opportunities as they are opened by the free market economy and not by the state

also of the long-run prospects of their firms. Beyond that, the creation of "elite" entrepreneurs through the intervention of the state must *be* avoided in the new form of economic system.

Fifth, a credit system which will be favorable to new enterprises, particularly in dynamic sectors, must be developed. Also, there must be adopted an indiscriminate state policy toward small scale enterprises which are going to be established. Regarding state enterprises the issuing of shares to individuals - mainly to the workers of those enterprises as it has been suggested by Aganbegyan, (1989, p.5) - is an advantageous solution to increasing managerial freedom in those firms.

Some of the above suggestions for the introduction and infusion of entrepreneurship could be dealt with in other formerly socialist countries like Hungary, where peoples' memory of a market economy is recent (Nove, 1972, pp.341, 360). In the case of Russia the introduction of entrepreneurship will be difficult because the structure of the old regime has not been yet changed. On the other hand, the demand for entrepreneurs and their function is big in Russia and other former "satellite countries". The main reason is that in the Russian economy profit opportunities are many and the demand for entrepreneurs and their function seems to be large compared with its supply. Recently, a young entrepreneur (30 years old) from Russia in his report to a Greek newspaper (*Eleutherotipia*, 1, February, 1992, p.15) described how he became rich in a few years by establishing a retail trade enterprise. He recognized that there was a profit opportunity because of market disequilibrium and discrepancies in the personal computer market and he acted as an arbitrageur (Kirzner's type of entrepreneur). He also argued that there are many profit opportunities in Russia and Russian entrepreneurs have an advantage compared to foreign entrepreneurs because they know the function of the Russian market and the operation of bureaucracy better.

Conclusions

The introduction and diffusion of entrepreneurship in the former Soviet countries cannot be accomplished in a few moments, nor can the fruits of entrepreneurship be a short-run phenomenon. Moreover, during the period of the establishment of new radical reforms, the resistance of the reactionary forces could create serious problems. Thus, many things depend on the qualities and the energy of Russian people as they adjust to a more individualistic and less authoritative climate.

We would like to close by paraphrasing the words of Pythia to the Spartans: Let the germ of the son of Jupiter (in our case the entrepreneur), return to your land (in our case in the former socialist countries), otherwise you will have to cultivate with silver plough (Thucydides, book. 5,16).

Notes

1. Individuals who have a strong belief in an internal locus of control are those who have confidence in their ability to influence the course of events (Brockhaus, 1982, p.43).
2. L. Baeck (1992, p.9) comments that: "The stultifying effects of bureaucratic centralism stifled the sense of initiative."
3. The restricted economic freedom of managers is considered by Bogomolov to be

one of the main weaknesses of the Soviet system. As he comments: "the socialist economy should be based on a sufficient freedom of producers and consumers" (1989, p.239), and "Market suggests democracy, since it cannot functionate normally in the absence of an economic independence of producers and consumers, of equal rights of different forms of ownership, freedom of choice by buyers" (ibid., p.242).

4. The former prime minister Kosygin, in his Report to the CPSU Central Committee, (25 September, 1965, ed. 1972) mentioned that "incentives must be organized so that enterprises will be interested in working out and fulfilling higher planned assignments, and in the better utilization of internal resources. In short, it is necessary to orientate all the activities of the enterprises towards seeking out means of improving the economy of production, of increasing its own incomes and thereby increasing the overall national income" (1972, p.325), "hence we need a system such as will induce our economic managers to be more concerned as to how to use investment funds in the more effective manner" (ibid., p.326).

5. The economist Libermann in *Pravda* (9 September, 1962 ed. 1972) recognising the lack of incentives in Soviet enterprises suggested: a scale of incentive payments for enterprises according to their profitability (1972, p. 310-1); and more freedom to enterprises in using their part of the profits (ibid, p 312) so as to "make it possible for the enterprise to compute for themselves the optimum combination of indices, with the final result being the best products, ones the consumers really need and that can be produced with the greatest profitability. Without this freedom of economic maneuvering it is impossible to increase sharply the efficiency of production" (ibid., p. 316).

6. In the Soviet economy, as Gregory and Stuart noticed (1981, p.181), "there is a tendency... to avoid changes, for the managers tend to expect a negative impact from process and product innovation. Such innovations are considered risky because they might endanger plan fulfillment during the current period, and they carry little Potential reward because output targets will simply be ratcheted upward if the innovations are successful." Thus, as Kaser comments, "...since risk is usually associated with innovation, there must be noted the Russian practice of copying and the

page 49

achievements of scale by the multiplication of units rather than by progress to a new level of technology" (1978, p.422).

7. In the United States today, as Baeck mentions: "An often voiced plea concerns the renewal of methods: greater concentration on the entrepreneurial qualities and less attention for technical tools of administration such as abstract scenario and model building" (1992, p.3).

8. The Soviets paid great attention to accelerating new technology and they "do fairly well with research (especially basic research), less well with development, and poorly with innovation" (Levine, 1983, p.247). However, their experiment, in 1965, to create a special innovative firm which could be used as the link between the technological institutes and production had no promising results (see Cooper, 1975, p.174-5).

9. Some Soviet economists and engineers had emphasized the slow rate of innovation in USSR. Aganbegyan (1977) noticed the powerful bureaucratic obstacles to innovation (see Bergson 1983b, p.59). The Chief Engineer of the Belorussian Motor Vehicle Plant and USSR State Prize Laureate, Z. Sirotkin, noted the unwillingness on the part of managers to introduce new technologies or new products as "The work rhythm is disrupted, and many new problems appear" (quoted in Bergson 1983b, p.60). He also mentioned that the reward to innovative managers was too small to be a strong

incentive for innovation (see Bergson 1983b, p.60). For a comparative analysis of the resources directed on research, development and invention between the centrally planned economies and the market economies, see Hanson and Pavitt (1987).

10. For more detail on his reform see Nove (1972, pp.354-6; 1977, pp.87-92); Berlinger (1983, pp.353-5), Houmanidis (1988, pp.305- 6).

11. Or to put it in Rugina's (1987) "Orientation Table for economics" the former Soviet system must be transformed from the model of the socialist-communist regime $M_6 = \text{Eco } 5\%$ (competition + Numeraire currency) + R6 (the institutional and legal framework consistent with the given system) to the capitalist mixed model of $M_4 = \text{Eco } 50\%$ (competition + Numeraire currency) + 50% (monopoly + anti-Numeraire currency) + R4, or near to it.

Numeraire currency = commodity or equilibrium form of money based on gold, silver or any other suitable commodity.

anti-Numeraire currency = paper or Fiat money plus monetized bank-credit or a disequilibrium form of money.

Further, it must be clear that model M_4 represents the Keynesian model at its limit (unstable equilibrium with unemployment). In order to have full employment and price stability - according to Rugina (op.cit.) - the former Soviet economy must be transformed from model M_6 to as close as possible to model M_1 or the Walrasian

Page 50

model at its limit: 100% (pure competition + Numeraire currency) + Ri. Once we move from the Walrasian model competition and monopoly are no longer pure.

12. On the other hand, as Kaser noticed: "The long history of Russian regulation before and after Peter has shaped many of the institutions and activities characterizing Soviet economic management, but that management allows no scope formally for the entrepreneur" (1978, p.493).

13. As Bajt puts it: "a complete revaluation of the individual's position in the society has to be brought about... People have to get persuaded that it is themselves who are creators of the fortune and misfortune, that all opportunities are open to them and that it is only up to their decision whether these will be grasped or left unexploited" (1989, pp.287-8).

14. As Nove mentioned a decade earlier, "it must surely be accepted that the major obstacle to change lies in a combination of inertia, habit and self-interest" (1972, p.359).

15. On this see Kaser, (1978, pp.456-7,474).

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Page 51

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Page 52

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Page 53

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Page 54
