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Transition economics meet new structural economics: editorial introduction

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The 2008 global financial crisis has spurred much debate regarding the soundness of mainstream economic theories, in particular of the so-called neoclassical economic mainstream and the closely associated policy approach known as the "Washington Consensus". As these theories and conceptual perspectives have played a particularly important role in guiding economic transition in central and eastern Europe and former Soviet Union, the global region most affected by the crisis, it is natural to use the experience of this region to ask important questions about the process of institutional change and economic development.

Over the last 25 years, the economies of eastern Europe and former Soviet Union – the European transition economies – have gone through a remarkable economic and political transformation, perhaps the most dramatic institutional change in such a short time period in history. However, that process now seems stuck – and stuck at very different levels of quality of economic and political institutions. Has the European transition model run out of steam and does it need to be replaced by some other model?

Moreover, all these economies experienced deep recessions in the early years of transition, sometimes losing up to half their output over several years. Many of them also proved to be vulnerable to the 1998 Russian financial crisis. After strong growth in the 1998–2008 period, these economies again experienced significant output losses in the first year of the global financial crisis. Were these vulnerabilities caused or at least amplified by the embrace of the model of global integration advocated by mainstream economics?

The global financial crisis did not affect all countries in central and eastern Europe and former Soviet union to the same extent. For example, central Europe and the Baltics came out of the crisis more quickly and growth has resumed, while southeast Europe still struggles with sluggish growth. Many resource economies in the region now also have to cope with the slowdown in the global boom and the volatility of prices in commodity markets. Can we exploit this variation within the European transition region to better understand how to create a less fragile basis for long-term growth?

The new EU Member States have anchored themselves to the wider EU institutional framework as a way to ensure international credibility and reduce trial and error and

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political gridlock in the process of building up economic institutions. In an international comparison, these economies are characterised by large "foreign direct involvement", i.e. "the inclusion of a large diversity of external state and non-state actors in assisting and monitoring domestic institutional change" (Bruszt and McDermott 2009).

Most of them are very open economies in terms of trade and they have well-developed markets, which have contributed to growth and a framework for revealing comparative advantages. This institutional anchoring has been accompanied by capital flows from the EU public and private institutions that were seen as a textbook response to the scarcity of modern equipment and infrastructure. FDI substituted for the lack of management experience and helped address technological backwardness. Finally, labour adaptability and mobility partially helped to limit the social cost of transition.

At the same time, "The benefits of EU integration for countries that are catching up are not and cannot be unqualified, but are conditional on the quality of national policies and the EU framework itself" (Becker et al. 2010). This rejection of "unqualified benefits of integration" challenges the mainstream views and reignites important debates regarding the key ingredients for growth. Transition economics (TE), as an academic conceptual framework for analysing a transformation process and for informing policy-making, has been the dominant perspective on growth and restructuring in the Eastern Europe and Former Soviet Union in the last 20 years.

Post-2008 experiences suggest that there are limits to unqualified growth and restructuring policies based on global integration only, i.e. without accompanying polices of industrial or technology upgrading. A large body of work has used the crisis as a quasi-experiment for understanding the fragility and potential weaknesses of the established conceptual frameworks and policy recipes. More generally, the experiences of the transformation of the Chinese and other Asian economies also offer potentially interesting lessons for the European transition economies.

In *New Structural Economics. A Framework for Rethinking Development and Policy,* Justin Yifu Lin summarises the development thinking underlying the Chinese and other Asian experiences. As the title suggests, at the core of this thinking is the importance of economic structure and structural change that requires attention to industrial upgrading. However, unlike old structural economics of the 1950s, "structure" in new structural economics (NSE) is endogenous. The aim of NSE is to marry the structural approach to growth with neoclassical economics, based on (a) understanding comparative advantages as the evolving potential of country's endowment structure; (b) relying on the market as allocation mechanism at all stages of development; and (c) recognising the facilitating role of the state in the process of industrial upgrading (Lin 2012).

Unlike NSE, TE represents an *astructural* approach to growth in terms of economic structure, but it has an articulated view regarding institutional structure. Increasingly, the TE framework has emphasised the role of the state as a facilitator or enabler of economic transformation and institutional change. The notion of "structural reforms" is a key ingredient in this perspective. NSE has much less to say on the issue of "institutional structures". Hence, it is logical to ask: Could TE and NSE be married or complement each other?

Is NSE a real alternative for post-socialist countries? Or is NSE primarily dealing with less-developed countries and hence less relevant for middle-income transition economies aspiring to move towards more knowledge-intensive or higher value-added activities? Or, maybe the European "transition region" itself is so diverse in terms of levels of development that no single theoretical lens can capture its complexity? Finally, is structure and structural change important for the most-developed transition economies in Central Europe that are structurally very similar to the developed EU economies?

A point of convergence between TE and NSE is that markets are the major mechanism of structural change, and that government is responsible for maintaining well-functioning and advanced markets. However, there are also important differences in nature of the role of government. These differences are reflected in their respective major analytical tools. The NSE operationalises its key insights in the Growth Identification and Facilitation Framework (GIFF), while the approach of TE can be illustrated by the so-called Assessment of Transition Challenges (ATC). The GIFF is primarily concerned with sustainable and long-term growth based on current and latent comparative advantages and is focused largely on the process itself by assuming that the government is able to maintain a competitive market environment as one if its major preconditions. The ATC provide sector-level assessments of the functioning of (i) market structures; (ii) institutions and policies that support markets; and (iii) market-based conduct, skills and innovation practices. So, unlike NSE, which is focused primarily on industrial upgrading, TE emphasises systemic change and improves the functioning of markets and the market-enabling institutions, where the role of the state is central. The GIFF says what industries a particular country should prioritise, whereas the ATC assesses how well a country's market structures and institutions, including existing industrial policy frameworks, identify priority activities, and how effectively it allocates resources to these activities.

The NSE suggests that policies are best understood in terms of consistent overall strategies, reflecting initial conditions. NSE distinguishes between comparative advantage following (CAF) and comparative advantage defying (CAD) strategies. The argument is that failure of the old structural economics is largely due to uncritical application of CAD policies. NSE argues that it can use the CAF/CAD framework to analyse soundness of innovation policies like the EU structural funds targeting traditional clusters for "smart specialization", primarily through ICT enhancement or the Russian *Skolkovo* science city.

TE is more sceptical about the ability of governments, particularly in weak institutional environments, to develop and implement sound overall strategies. Instead, it focuses on developing markets and market-enabling institutions and tries to anticipate political economy considerations in shaping national policies. TE is essentially agnostic on whether, in general, policies should focus on comparative advantages or be driven by within-industry considerations – it depends on the institutional context – but the state has an important role in ensuring that competition is allowed to influence the entry and exit of firms in different sectors and at different stages of the value chain. TE sees externalities as the key rationale for innovation policy, and as the basis against which to assess policy initiatives. In other words, initiatives to compensate for weaknesses in the general innovation climate, like the EU smart specialisation policies or science cities such as Skolkovo, are defensible only to the extent they address these externalities.

In addition to NSE and TE, a broadly defined neo-Schumpeterian political economy (NSPE) and Schumpeterian economics can be considered as variants of a third conceptual alternative, which has many common points with NSE and some overlap with TE. The NSPE epitomised in the volume edited by Cimoli, Dosi, and Stiglitz (2009) focuses on knowledge accumulation as a central process central to any industrialization strategy, occurring within, but not exclusively within, business firms. As in the NSE, there is a focus on industrial upgrading, and industrial policies are seen as intrinsic fundamental ingredients of all development processes.

However, unlike NSE and TE which have developed operational policy frameworks (GIFF and ATC), this perspective is sceptical regarding such tools. Instead, effective industrial policy is seen as the interplay between "ingredients", such as investment in human capital and subsidies to pivotal sectors, and the "institutions" allowing the coordination and exploitation of knowledge, rather than rent-seeking (Cimoli, Dosi, and Stiglitz 2009). The crucial growth process is accumulation of technological and organizational capabilities, which need to be "matched, first, by a congruent 'political economy' offering incentive structures conducive to 'learning-based' rent-seeking while curbing rent seeking tout court, and, second, by a congruent macroeconomic management" (Cimoli, Dosi, and Stiglitz 2009). Instead of a "magic policy recipe", only some basic ingredients and principles could be identified from the experience of successful policy arrangements.

Schumpeterian growth theory introduces an important distinction between innovation and imitation. Imitator countries catch up to a global technology frontier, which represents the stock of global technological knowledge available to all innovators. A country's growth path and its innovation pattern are determined endogenously by the process of competition between a prospective innovator and the competing fringe of producers. Within this perspective, the intensity and mix of innovation often depends upon institutions and policies, but in ways that vary with the distance of the country from the technological frontier (Aghion and Howitt 2006). Lee (2013) also argues that different development strategies and policies are required at different stages of economic development.

Foray (2015) applies the Schumpeterian ideas within the framework of "smart specialization", but mostly for countries at technology frontier. A volume edited by Radosevic and Kaderabkova (2006) applies this perspective in the context of the CEEC countries. Policies that are conducive to the growth of a country's innovators are not necessarily those that are favourable to growth of imitators or countries farther away from the technology frontier. This limits generalizations based on Schumpeterian approach, and policy is always context (country and sector) specific. This feature of NSPE and Schumpeterian growth theory stands in sharp contrast to TE and NSE, which both articulate more elaborate policy views.

As emphasised, the common foundation of all three perspectives is the reliance on markets. However, their views of the market are not identical. Cimoli et al. (2007, 1) have a pragmatic view, where "markets sometimes work in a 'developmental' sense, sometimes not, and even when they do work, their effectiveness cannot be separated from the contribution of supporting institutions and policies" (Cimoli et al. 2007, 1). In Schumpeterian growth theory also, the functioning and role of markets and competition depend on where a country finds itself relative to the technology frontier. On the other hand, the TE approach has a narrower, but institutionally quite articulated, view of markets as indicated by the ACT. The NSE in somewhere in between and more akin to the (neo)Schumpeterian perspective.

Finally, neither NSE nor TE is very explicit about the state capacity to implement policies, but TE implicitly internalises the delivery capacity of governments in its ATC. NSPE (economics) takes into account the institutional context of policy and (un)productive nature of rents and their effects on technology accumulation. The state potentially plays important roles in generating information and bringing stakeholders to the table. However, such coordination associated with large externalities seems important until a certain level of development, but increasingly difficult in the post-catch-up phase like, for example, in today's Korea. Also, NSE and TE approaches abstract to some extent from the institutional context of industrial or technology policy. All three perspectives are silent on the theory of the state underpinning their respective approaches. Integrating such theory into the analysis is critical for further advancement.

The NSE and (neo)Schumpeterian approaches aspire to be new paradigms in development policy, while TE has de facto been operating as such a paradigm in the context of Eastern Europe and FSU. They all represent powerful heuristics with far-reaching implications on different policy areas. In policy terms, Eastern Europe and Former Soviet Union face three choices. First, continue and speed up structural reforms, hoping that this may solve the current economic crisis. Second, revisit old structuralist approaches and attempt to go back to “big push” thinking. Third, explore alternatives like NSE and (neo)Schumpeterian approaches, possibly in combination with one of the two first approaches. The papers in this thematic issue of JEPR should be seen as contributions in this context.

Papers have emerged as the outcome of a workshop held at the University College London, School of Slavonic and East European Studies, in London on 25 and 26 June 2013. The workshop was preceded by a call for papers, and the papers which passed the peer review process are published in this issue. Presentations and discussions from workshop are available at http://www.ucl.ac.uk/ssees/research/research-centres/economics-and-business-seminar-series/transition-economics-meets-new-structural-economics/programme.

The accompanying output of the workshop is the Discussion Forum, which presents major “think pieces” or short debate-focused contributions by Michael Landesmann, Dominique Foray, Natalya Volchkova, Mario Nauro Campos, Peter Sanfey and Justin Yifu Lin. These are published in a forthcoming issue of *Journal of Economic Policy Reform*.

This issue of *Journal of Economic Policy Reform* is unique, in that, for the first time, it brings into direct communication the ideas of TE, NSE and EU “smart specialization” (Foray 2015), rooted in the Schumpeterian approach. EU “smart specialization” is a very large-scale effort by the EU to push countries and regions to formulate their smart specialization strategies to avoid a situation where too many regions are aiming for similar technologies and markets and thus outcompeting each other.[1] Smart specialization is based on market-based determination of priorities determined in bottom-up process labelled “entrepreneurial discovery” process (Foray, David, and Hall 2009). In that respect, it shares certain features with, but also differs from, NSE.

Justin Yifu Lin’s paper “The Washington Consensus revisited: a new structural economics perspective” (Lin 2015) is a vivisection, applying the NSE perspective to the Washington Consensus approach to transition in former socialist economies and other developing countries. Central to his argument is the neglect by Washington Consensus of the viability of ex-socialist firms in an open, competitive market as they were not consistent with the comparative advantage determined by the economy’s endowment structure. The Washington Consensus did not pay sufficient attention to the endogeneity of these distortions and instead, focused on institutional environment, while neglecting the viability of firms, which led to protracted transitional recessions. His conclusion is that it is essential to relax the implicit viability assumption when applying the neoclassical approach to study the problems in those economies.

Berglof (2015), in his paper “New structural economics meets European transition”, presents three policy perspectives – NSE, TE and the Neo-Schumpetarian approach – and shows that each of them emphasises different aspects of structural transformation, which he understands as the transformation of the economic structures as well as of the associated institutional structures. Their relative explanatory power depends on the context and the questions we are interested in understanding. He concludes that both NSE and TE offer very general narratives, with messages on structural transformation largely independent of the historical context and where a country finds itself relative to the world technology frontier. Given that the Neo-Schumpetarian approach considers how economic structures and institutions need to change along the journey towards the world technology frontier, he finds it in this sense more helpful in guiding policy in a particular country. Yet, he argues that the Neo-Schumpetarians have yet to understand better how the legacy of attitudes and values and broader collective memory influence economic structures and institutions today. In a nutshell, a better understanding of the behavioural aspects of structural transformation is needed to break down behavioural barriers to entrepreneurship and cross-border investments.

The paper by the UCL team (Bruno et al. 2015), "Technology choices and growth: testing new structural economics in transition economies", tests and extends key propositions of NSE to extend its empirical research program. First, it confirms the overall relevance of technology distortions for growth, but finds that this does not generalize to the overall group of TEs. The NSE propositions appear to be valid for middle-income countries and less so for more-advanced economies. Second, the paper finds a negative relationship between, on the one hand, financial and technology distortions, and on the other, medium-term growth. However, they also point towards some positive externalities of simultaneous financial and technology sector distortions, at least in the medium run. Transition economies differ from the rest of the sample, as financial distortions have a more-pronounced direct negative effect on their medium-term growth.

Muscio, Rivera Leon, and Reid (2015), in their paper, "An empirical test of the Regional Innovation Paradox: can smart specialisation overcome the paradox in Central and Eastern Europe?", test whether lagging regions in greater need to invest in innovation have the capacity required to absorb funding for innovation. Their conclusion is that support for research and innovation through Structural Funds does not sustain a virtuous cycle of growth and catching-up. They argue that the CEE innovation systems may have reached their limits in terms of their capacity to absorb these funds largely due to the limited human and financial capacities of indigenous small- and medium-sized firms. To relax these constraints, innovation governance must improve. Implicitly, their conclusions suggest that the issue is not only where to invest or how to achieve smart specialization, but also equally important is the capacity of actors in the innovation system to self-organise and coordinate.

Karo and Kattel (2015), in their paper, "Economic development and evolving state capacities in Central and Eastern Europe: can 'smart specialization' make a difference?", explore the issue of state capacities for smart specialization. These capacities have been implicitly assumed when the concept has been successfully applied in more-developed economies, but in the CEE, governments and policies may function differently and reforms to existing policy and administrative routines may be required. In particular, there is little experience required in CEE of public–private coordination in design and implementation. The authors provide some tentative guidelines for gradually improving policy and administrative routines in support of smart specialization in CEE.

Post-2008 period policy-makers have searched for new policies that will revive growth and technology upgrading, especially in economies that followed the policy logic of Washington Consensus. This thematic issue brings academic contributions that are highly relevant for exploring new policy philosophies and approaches that further debate on these issues, especially in the context of the CEE and CIS. We hope readers will appreciate the richness of what have previously been seen as sometimes disparate contributions brought together in this volume as well as the ensuing discussion by experts invited to the accompanying Discussion Forum in a forthcoming issue of Journal of Economic Policy Reform and find that they advance academic and policy debates in the area of policy reforms.

Disclosure statement

No potential conflict of interest was reported by the authors.

Note

1. Engaging in a process of smart specialisation is ex-ante conditionality for the use of EU regional and cohesion funds.

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