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THERE IS NO GROWTH WITHOUT CHANGE: POLICY IMPLICATIONS FOR TRANSITION ECONOMIES

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Abstract

Prolonged economic stagnation, which former socialist economies are facing since the crisis of 2008, suggests that fundamental economic problems inherited from the socialism have not been properly addressed by transition reforms. We develop a conceptual framework of sustained economic growth through continuous change. In analysis of underlying factors and aspects of economic change as innovation, entrepreneurship and socio-institutional factors we argue that sustained growth depends on the ability to continuously generate change. We suggest policies aimed at transforming transition countries into economies capable to continuously generate change.

***Keywords**: economic growth, structural change, transition economies, economic change.*

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1. INTRODUCTION

Sluggish recovery after global economic recession 2008-2009 with prospects of turning into of prolonged economic stagnation across transition countries of the Central and Eastern Europe and of the former Soviet Union evidently suggests that stagnation is not only an ill of socialism. After more than 20 years of market reforms, stagnant centrally planned economies were replaced by stagnant capitalist economies. The very title of the "Transition Report 2013. *Stuck in transition?*" of the European Bank for Reconstruction and Development (EBRD, 2013) clearly and precisely describes current economic and reform situation in post-socialist economies. EBRD report raises concern that "transition region does indeed face a serious long-term growth problem and that, given the current policies, convergence with Western living standards (...) will not be achieved in most countries". Economic crisis of 2008 exposed vulnerabilities of growth strategies of transition countries due to their over-reliance on the foreign direct investment. EBRD's Report rightly indicates that the causes of reduction in long-term growth prospects although has coincided with the crisis, are only partly related to that crisis. The future prospects of stagnation across transition economies suggests that fundamental problems of centrally planned economies remains unsolved in a sense that lessons from the failure of centrally planned system have not been learnt, and this requires different view not only on transition policies, but reconsidering what we know about economic growth.

Radical and massive transition policies were not aimed to solve particular economic problems as well as achieving long term economic goals. Kolodko (1999) sees the lack of success of transition policies in "the confusion of the means of the policies with their ends". For transition economies economic growth was simply sought as an indicator of the progress in transition reforms, as liberalization, privatization and stabilization (Staehr, 2003, Falcetti et al., 2006), Dillon P. and Wykoff F. (2002).The point however is that research on transition focuses mostly on performance of transition reforms, debate on gradualism or shock-therapy; and do not address solving inherited economic problems. It is now obvious that standard transition policies menu have exhausted itself and even could be misdirecting at achieving long-term goals.

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Dramatic collapse of centrally planned system, accelerated by political events exposed existence of many problems in socialist countries. Yet, the desire to solve all problems as fast as possible in haste implementation of transition reforms eventually made many forget about the causes of the fall of the centrally planned system. Thus, many important lessons from failure of the centrally-planned economy have not been learnt. Although the transition to capitalism was aimed at solving all inefficiencies of socialism at once, it could not solve fundamental problems of socialist economies and this is because of misunderstanding of the workings centrally-planned economies and because of simplistic and unrealistic vision of how modern market economies work.

The ultimate goal of transition reforms, to "put *(transition countries)* on the path of sustained growth" (Kolodko, 1999) has not been achieved because transition policies did not address economic stagnation, as fundamental problem of the socialism, inherited by transition countries. In order to suggest policies which will help to achieve sustained economic growth, first we need to re-consider the very conceptual foundations of economic growth, its sources and mechanism. Theoretical growth models are inadequate to properly address inherited socialist problems and provide guidance for policy makers in transition economies simply because in such models market and its elements, as competition and entrepreneurship are missing. Our argument is that economic growth can be better understood if viewed as process of continuous structural change. Recognizing this and understanding factors and forces that shape structural change brings at better understanding of mechanism of economic growth in capitalist economy and broad possibilities on how to achieve sustained economic growth. Particularly, we argue that transition can be successful if the process of transformation of stagnating economies into economies capable to continuously generate structural and qualitative changes is achieved.

The remainder of the paper is structured as follows: Chapter 2 reconstructs conceptual framework of the mechanism of economic growth in the free-market economy. Chapter 3 provides discussion on the process of economic change and mechanism of economic growth. Chapter 4 highlights problems in socialist and transition economies. Chapter 5 suggests policy implications and chapter 6 concludes.

2. MECHANISM OF ECONOMIC GROWTH IN A MARKET ECONOMY

Three sources of economic growth

Economic growth theory developed variety of formal models, yet they can provide little guidance for policy makers on the question how to achieve sustained growth. In neoclassical growth models economic growth presented not as complex socio-economic phenomenon, but rather as simple mechanical process in which accumulation of capital and productivity growth play a key role. However, there are two main problems which make it difficult to apply traditional growth models to analysis of market economy. One problem is aggregation of production. The traditional notion of growth focuses largely on quantitative changes in the aggregate output and does not capture many structural and qualitative changes which take place during the process of growth. Leading theorist of economic growth Robert Solow (Solow, 2007) admits that "*(p)*ure production-function reasoning at the aggregate level may miss an important part of the story." In these models a firm is reduced to productive activity and then such simple version is enlarged to the size of economy. However analytically convenient such approach may be, it leaves no place for key elements of market economy - market, entrepreneurship, competition, which makes it no different from the model of the planned economy. As Baumol (2002) correctly notices that "none of them (*growth models*) has any attribute uniquely related to free-enterprise economies rather than some other economic form." Second problem is equilibrium approach, which does not describe "restless" (Metcalfe, 2002) ever-changing capitalism, because growth of knowledge which it generates is not brought by forces of equilibrium, but rather of disequilibrium.

The problem to develop a model which would include market and address the problem of sustained economic growth is rather a conceptual. There is serious misconception of what economic growth is. We suggest that economic growth should be viewed as a truly long-run phenomenon, and not just extrapolation of short-run events. In the long run not only quantitatively, but qualitatively different events take place; therefore economic growth should be viewed both as quantitative and qualitative transformation. Finally, economic growth is continuous and sustained process. In order to address these issues we disaggregate economic growth into three broad conceptual sources: *increase, structural change and change*. Such distinction is also required for methodological reasons.

Increase

Economic growth traditionally means quantitative change or increase in aggregate output. This quantitative growth paradigm also includes increase in capital, productivity growth, savings rate, etc. In other words, it includes everything that can be measured quantitatively in dimension "increase-decrease". We do not associate it with particular growth theory or model, as this paradigm of growth can be applied to most of them, particularly with steady growth models. This dominating paradigm of growth, however it fails to provide consistence with other important facts of economic growth, i.e. structural change and qualitative change.

Our point however that this quantitative increase of output or factors is only part of the whole process of economic growth. And for the reason that focusing solely on quantitative increase and neglecting qualitative and structural changes brought by such increase does not allow to call such increase an economic growth, as a long-run phenomenon. Without changes in structure of economy such increase in the long run is simply impossible.

Structural change

The most profound feature of growth is that during the process of growth the structure of economy fundamentally changes in terms of composition of output and employment. Economic growth models are founded on one good (one sector) aggregate linear process and largely neglects structure of economy and its changes. Clark (1937), Kuznets (1966) and Chenery and Syrquin (1975) have established link between structure of economy and level of development. They argue that as economy grows, the production shifts from agriculture to manufacturing and to the service sector. At the same time the causal relation between growth and structural change is not straightforward and one-way (Dietrich, 2009). Economic growth brings about changes in the structure of output and employment, at the same time these changes affect growth. Kuznets (1966) sought structural change as the outcome of economic growth. Felipe et al. (2010), among others, emphasize the role of structural transformation in growth and development. Metcalfe (1994) views the problem of growth a problem of adaptation of expanding economic systems by changing the allocation of resources and the composition of demand. Since economic activity is ordered and structured it is therefore natural to assume that any increase would affect that order (structure). Kuznets (1973) distinguishes three main causes of structural change observed in developed economies - the different sectoral impact of technological progress, the differing demand income elasticity and the comparative advantage in foreign trade. Indeed, structural change is important mechanism that can ignite and accelerate growth through industrial upgrading; however it can provide no answer to the question what makes growth sustained? Structural change does not start with industrialization and ends at service based economy. Significant changes continue to take place within sectors as structural change continues in form of evolution of sectors and most important in emerging of new activities, which replace old ones. In globalized economy some countries may skip phase of industrialization and achieve middle income level by turning from agricultural to service based economies.

Reallocation of labor performs function of device which links structural change to economic growth by reallocating labor from low productive (low value) activities to higher (high value) productive activities. Resources shift from activities experiencing slow-down of productivity towards activities with increasing productivity in a process of continuous improvement in

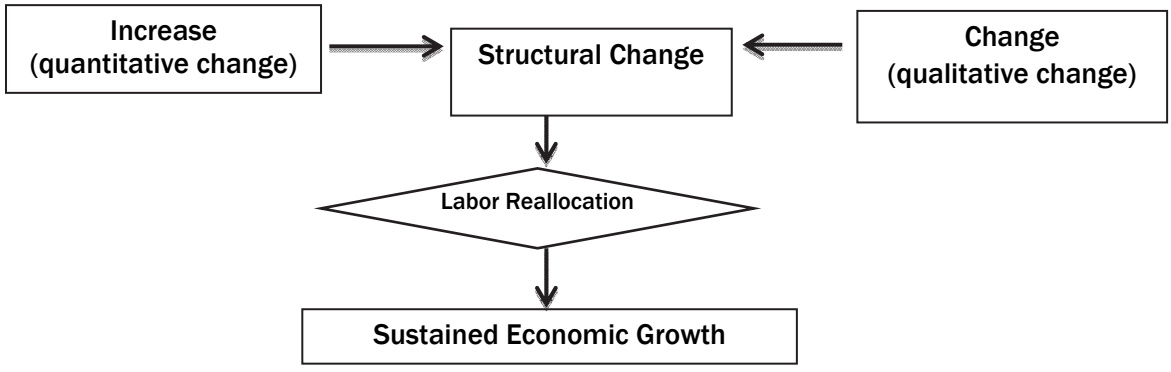
allocation of resources. Thus, structural change contributes to overall productivity growth through resource reallocation, working as source of growth (UNIDO, 2009). Therefore, sustained economic growth is not possible without continuous structural change and continuous relocation of labor.

Change

Economic growth is not only the process of quantitative increase and structural change. It entails profound qualitative changes, which cannot happen only as a result of increase of aggregate output or productivity. To better understand how these qualitative changes take place we need to separate them from quantitative category of increase into qualitative category of *change*. Change is often used as metaphor in theories of development, which is thought as by-product and consequence of quantitative growth. Within growth and development theories change was never attempted to be explained explicitly in a formal way.

Before we try to explain in a more formal way what is behind metaphor of change, we bring these three sources of economic growth together in consistent and complete framework of economic growth (Figure 1). From *increase* side uneven increase in productivity rates contributes to structural change and qualitative material changes contribute to it from *change* side. It would be correctly to say that economic growth is not only the process of increase; but equally it is a process of change. It can be said that economic stagnation is not absence or slow growth; equally it is absence of change. In our discussion we place structural change and quantitative change not as by-product of increase in aggregate output, but as most important sources of sustained long-run economic growth. Each source of growth plays different role at different stages of development. At the stage of industrialization capital accumulation, productivity growth and human capital accumulation play key role. However goods and physical capital are not accumulated physically. At some point of time old (not necessarily physically old) machines and goods are being replaced by qualitatively new. Economic growth does not mean producing more of the same goods, but it necessarily entails shift to new activities, and abandoning old activities. The driving force in that shift is process of innovation, which is qualitative change. At higher level of development growth is not dependent on factor accumulation or productivity increase, but on ability to continuously generates qualitative changes. Such qualitative changes are not only limited to material changes (innovation), but also social and institutional change. The role of continuous qualitative change as a source of sustained economic growth increases even more as development proceeds.

Figure 1. Mechanism of Sustained Economic Growth



It is difficult to find a proper place for transition economies in the theory of economic growth or development. We suggest that neither is able to properly explain problems of transition economies, because neither addresses the problem of sustained growth. In contrast economic change paradigm views economic growth and development as process of continuous change, which addresses problems of transition economies, as well as developed(Table 1).

Table 1. Key Differences Between Approaches to Development

	Economic growth theory	*Development economics*	*Economic change*
Forms of growth and development	Linear increase of aggregate output	Stages of development	Continuous change
Classification of economies	Low-, middle-, high-income	- Underdeveloped, - developing, developed - Pre-industrial (agrarian), industrial, post-industrial (service-based)	Changing, not-changing (stagnant)

Making sense out of metaphor of change

The concept of change which we brought explicitly in the framework of economic growth needs further discussion. Indeed, explaining what change is, is a theoretical challenge not only for economics, but for a science in general. Change is not a category of natural science, it is philosophical, metaphysical category which so far is difficult to conceptualize and formalize. The classical mechanics, whose mathematical approach is adopted by neoclassical economics, simply does not deal with category of change.

The distinction between quantitative category of *increase* and qualitative category of *change* is very important, because of the use of completely different analytical tools when explaining these categories. Methods which are traditionally applied to quantitative categories (linear, static or dynamic analysis) become inadequate when explaining qualitative changes. Particularly, describing change with static, nevertheless measurable, categories or explaining qualitative change as a function of quantitative variables brings misconceptions of change and is therefore misleading. Bringing discussion about nature of change in analysis would allow better explain qualitative phenomena in a more formal way. Although change is difficult to properly explain, measure and predict due to its non-linear properties it can be better understood if viewed not as one-time event, but as continuous process.

The analysis of change in economics requires handling categories which are different from quantitative change (more-less). Capacitive change or technological change which can be measured in terms of size, speed, weight, etc. is also form of quantitative linear change. Truly qualitative changes cannot be properly described as objective truth, as physical phenomena and expressed through quantification. Even though that change necessarily involves time; it cannot be properly analyzed with categories of time (past-present-future). Qualitative change is just a human perception.

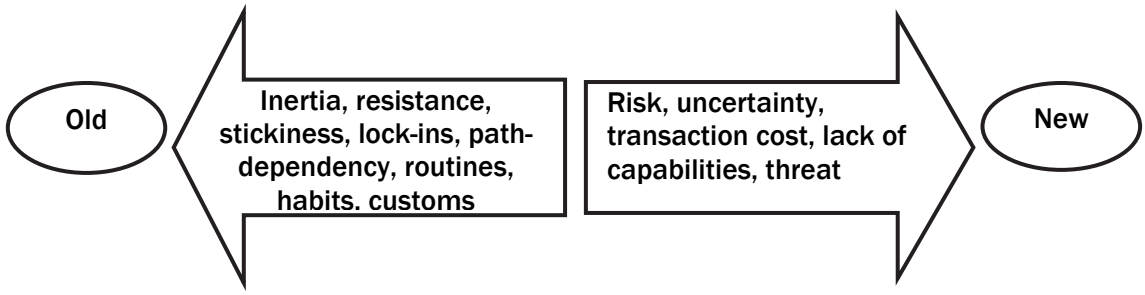
But how can we formally explain qualitative change? One step is to say that change takes place when new replaces old. This means that there are two processes which generate change. First, it requires creation of the new (novelty) and second it requires abandoning of the old. Again, different from any natural science, which can explain change through quantification, in social science change involves perceptive relation between new and old. The difficulty to formally describe change in economics arises because of subjectivity of what is old and what is new. New and old are interrelated categories. New is considered to be new if measured against already existing things. And old is considered as old, only when new emerges. Vision of change as creation of new only which can be presented as linear process brings misunderstanding about the true process of change. Change takes place when new is created and accepted and old is rejected. However this does not happens instantly, as in material world. Emergence of new and abandoning (destruction, loss) of the old are two counteracting processes. Removing old does not necessarily lead to emergence of new and emergence of *new* does not immediately replaces *old*. Change is not a single event, when new immediately is accepted and instantaneously replaces old. Change is time taking process when new and old co-exist together, even when they belong to different periods of time. New replaces old gradually. There is natural inertia or even resistance to change which makes it difficult to happen,

makes it time-taking and path-dependent process. Radical change, when the new instantaneously and completely destroys old is extremely rare. Radical changes require either destruction or painful adaptation. Most of changes are incremental therefore continual and endogenous. In other words change is the process of "creative destruction", using words of Schumpeter.

The meaning of change is hidden behind many qualitative concepts, which represents particular case of change. They include such concepts as invention, innovation, technological progress, social change, reform, improvement, invention, transformation, etc. In our context transition is also form of change. The emergence of new is very difficult process due to factors associated with it, as risk, uncertainty, transaction cost, lack of capabilities, even threat. Counterforces of change are behind such concepts as resistance, inertia, momentum, path-dependence, habits, lock-in mechanism, etc. (Figure 2). The working of these two forces represents change as a process of choice between old and new.

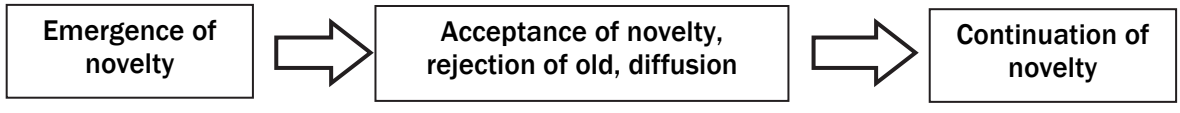
However, change cannot be explained properly through the standard prism of rational choice paradigm, because it cannot be reduced to act of rational choice between old and new, as existing alternatives. Change is founded on two forms of human action, which are distinctively different from rational choice. On the one hand, change is a purposeful and intentional act, which is driven by unique human ability to act creatively and to bring into existence new things. On the other hand, resistance to new makes change hard to generate, let alone resistance to change is rather a norm at individual, organization or societal levels[2].

Figure 2. Change Perception in Relation Between Old and New



Recognizing that the concepts of new belongs to the category of change brings about better understanding how novelty emerges, and replaces old in being adopted, diffused or disseminated and how long it remains new (Figure 3). In the process of change creation of new and destruction of old are not necessarily two separate processes. Creation of new and destruction of old is organic endogenous mutually dependent process, which means that transforming old into new is also form of change.

Figure 3. The Process of Change

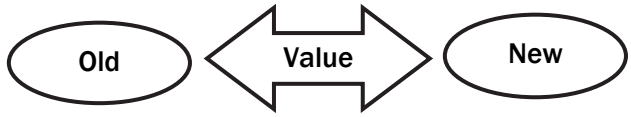


Change paradigm will challenge most of existing theories of value, all of which are quantitative. Debate on what is (economic) value is difficult without categories of change as new and old. The emergence of new has effect on value of old. However change means that both old

[2] Paraphrasing Keynes, the difficulty of change "lies, not in the new ideas, but in escaping from the old ones" (Keynes, 1936, p. xxiii).

and new co-exist for some time. The value indeed exists because of this fact (Figure 4). The origin of this value is underlying force which eventually drives economic growth, as increase in value of goods and services produced.

Figure 4. Change as the Process of the Emergence of the Value



What distinguishes humans from animals or machines is perception of change and ability to generate change in form of creativity. Change is the result of human intention and act therefore it cannot be explained properly using methods of natural science. Evolutionary economics represents change in analogy of the process of selection in biology (Witt, 1992), which may be inappropriate. Neoclassical economics focuses on choice as ultimate element of purposeful rational human action. Human relation to change and novelty is neglected. While it would not be an exaggeration call economics as a study of human-made change at the same time no school of economics can address change as man-made socio-economic phenomenon.

3. The Process of Economic Change and Mechanism of Economic Growth

3.1 Material change

Innovation and market process

Structural change means not only shift in relative shares of employment between particular production activities, but most importantly it means emergence of new activities. It necessarily entails process of emergence of new goods and services, in other words material change. Thus product innovation is ultimate driver of structural change and therefore economic growth. Stokey (1988) and Aoki and Yoshikawa (2002) emphasized importance of introduction of new goods for sustaining demand and economic growth. New goods have higher value than old ones, thus the process of innovation reflects basic motion of structural change – shift of activity from low-productive (old goods) to higher productive (new goods). Structural change is a result of continuous process of change. Continuity of product evolution is necessary condition for sustaining structural change and therefore growth.

The mechanism of generating novelty through innovation in centrally planned and market economies is substantially different. While in the former it is directed centralized, planned and its pace is predictable, in market system the direction of innovation is mostly unpredictable and decentralized. Innovation in free-market economies is facilitated by varieties of market mechanisms and shaping them institutions, most of which are neglected in traditional models. While being necessary, private property is not the only and not sufficient institution for innovation in market economies. One such mostly neglected mechanisms of innovation at the market process are competition and entrepreneurship.

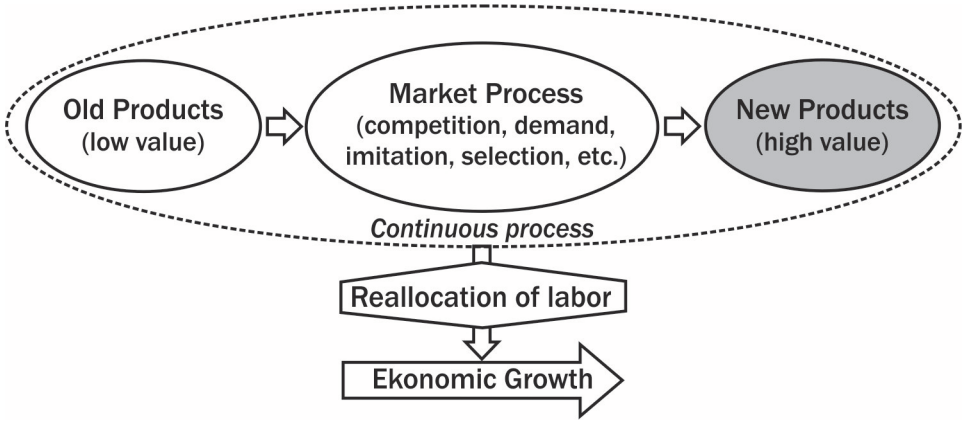
Competition promotes and disseminates innovations. Presence of competition facilitates this process in following way: firms try to be different and at the same time they imitate successful innovations of competitors adding own small, incremental changes. Thus competition through imitation creates diversity, which diffuses innovation and as a result accelerates evolution of product and replacement of the old products. Imitation mechanism of competition works as mechanism of change through organic transformation of old into new.

It is commonly believed that innovation is knowledge and in empirical research innovation is often associated with either spending on research and development (R&D) or number of patents or creation of new firms. This is misrepresentation of what innovation is. R&D or number of patents themselves does not guarantee emergence of new goods on the market. R&D represents just cost, and patents are just an idea, which makes them poor proxy for innova-

tion. Besides that viewing R&D as the only indicator of innovation focuses only on science and research based forms of innovation which is associated with hi-tech industries. This excludes large part of others, mostly medium and low-tech activities, where new product innovation takes form of introduction of numerous non-technological novelties, as design, marketing or branding, which are essential in market economy. Besides that, non-technological innovations are easier to imitate. Any activity which generates modifications of products intensely can be considered as innovative. Efforts or costs spent on innovation process do not necessarily mean success of innovation activity. Thus innovation efforts should necessarily entail commercialization of ideas or discoveries through their commodification. Commercialization of innovation is important and probably most difficult part of innovative process, which brings innovations for the evaluation to the market. Commercialization means embodying knowledge into product or service for the test of the market. Structural change is not shaped by efforts valued in how much spent on their development. Structural change is shaped by goods or services which have value for users. From this point of view the best indicator of innovative activity would be the number of new products, introduced to the market within some period, including modified versions. However, to our knowledge such statistics does not exist.

Not all innovations contribute to structural change, because not all innovations are successful. Structural change is directed by successful innovations. Innovation is a process of trial and error. Competition not only accelerates process of innovation through "experience of others" but also works as collective learning process. Market process is a process of economic communication; it is a mechanism where experiments with innovation, their testing, learning, adaptation take place. Market process is about production of change and on adjustments to it (Foss, 1998). Successful innovations show where innovative efforts are profitable, and failures show firms what to avoid. Market mechanism directs firms' innovative efforts, thus market process eventually determines direction and the speed of structural change. Commercialization of incremental innovations makes this process less risky, than commercialization of genuinely new products. The slow pace of introduction of new products may indicate high level uncertainty related with commercialization of innovations. Market is the place where value of novelty is created, without properly functioning market mechanism creation of new value and establishing value for new products is impossible (Figure 5).

Figure 5. The Process of Innovation and Economic Growth



Entrepreneur and firm

The process of human-made change necessarily involves someone who generates the change. There is no need to introduce a new category, since this task can be successfully assigned to entrepreneur. The misconception of what innovation is, discussed above, places engineer, researcher or inventor at the center of market economy and leaves no place for entrepreneur in this process and in economic theory. Often entrepreneur is presented as self-employed person, a creator of new small firm and his contribution to growth is considered only as a generator of employment (e.g. Audretsch and Thurik, 2001). This narrow view of entre-

preneur has led to exclusion of whole categories from category of entrepreneur, particularly existing large firms and their employees.

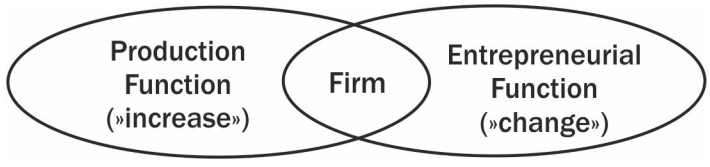
North (1990) described individual entrepreneur as an "agent of change". Therefore entrepreneur's abilities to generate change and be "alert to change" can make anyone entrepreneur. Entrepreneur does not invent herself; she discovers opportunities, created by others. She explores possibilities for commodification of ideas and discoveries. She experiments and tests her innovation in market process. Finally she is the only one who takes risk for her action. Entrepreneurship is a category which includes variety of actions, such as taking risk, or exploring or creating opportunities, but most importantly it is an attitude to change and ability to change in other words, innovativeness and flexibility[3].

Here we distinguish between initiating and imitating entrepreneur. Innovator creates novelty, initiative entrepreneur test it on the market, and imitative entrepreneurs replicate successful innovation. For imitative entrepreneurs others' innovations can "pave the way" for one's own innovations (Holcombe, 2007). In other words entrepreneur makes his discoveries at the market place. What makes entrepreneur behave like creative entrepreneur is opportunities created by competition. Profit motive itself is not a reason for innovative behavior. In the absence of competition profit turns into economic rent which brings about destructive rent-seeking entrepreneurs.

In a free market economy firms performs not only production function, but also entrepreneurial function (Figure 6). If production function can be described with mathematical expression of production function (e.g. Cobb-Douglass), then an attempt to describe entrepreneurial function in proper mathematical expression is impossible, because it is expressed in terms of "change". Moreover, the desire to express it by substituting it with measurable, static or linear variables or embed entrepreneurial abilities into production function as factor of production may lead to misrepresentation of what entrepreneurial function of the firm is. We can say that production function is dependent on the entrepreneurial function, because combination of factors their productivity and how much is produced are ultimately determined by what is produced.

Distinction between "increase" and "change" we made earlier is natural from the point of view of the firm. Firm is not only production unit (factory, plant), but also it is innovative unit, which introduces new products. Firms introduce new goods to escape from diminishing returns, and in turn introduction of new goods requires different technology and amount of factors.

Figure 6. Firm in a Market Economy



3.2 Socio-Economic Change

Changing material world also entails changing attitude to material things, which means changing beliefs, social norms. Material change does not proceed in isolation from social aspects. Innovation is embedded in institutional and social context.

Institutional and social change. The degree of perception of change and attitude to change and novelty is different in individuals, cultures and stages of development. Fast-changing and slow-changing cultures co-exist in modern world.

Different stages of economic and technological development are referred to different level of social organization and institutions. The relation between material and social change is

[3] For extensive overview of entrepreneurial functions see for example Grebel (2008), Rocha V.C. (2012).

not one-way. On the one side changes in social customs and norms have effect on all other economic relations which eventually translate into material change and at the same time material innovation induces new institutional arrangements (Freeman, 2002). Innovation involves institutions which in turn supply knowledge and skills which underpin innovative activity(Metcalfe, 1994). Although innovation is driven by market competition, competition itself is institution of market economy and entrepreneurship is its social aspect. Innovation and entrepreneurship is distinguishing qualities of "culture of change".

In Schumpeter's view (1911) entrepreneurship is product of the institutional structure of society. Societies where institutions reward entrepreneurial activities have a high level of entrepreneurial activities. Institutions fundamentally direct entrepreneurial activities to productive, unproductive or destructive forms (Henrekson and Sanandaji, 2010). North (1991) defines institutions as "humanly devised constraints that structure political, economic and social interaction". Institutions as technology do matter but we cannot to answer which, as we cannot say which technology matters. As a technology, institutions are not static, they evolve; and since they are interdependent and complement each other, then what is more important is that how they coevolve. North's view on the role of institutional change as incentive for economic change: *"Institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline."* (North, 1991)

Nelson (2008, p. 9) argues that "long-run economic change must be understood as involving the co-evolution of technologies in use and the institutional structures supporting and regulating these". Slow institutional change may not be matched with the faster pace of technological change, which may slow down technological change. Imported formal institutions aimed at facilitating technological change may not work, because informal institutions may be rigid. Some social structures, for example collectivist, may resist innovation as it would threat informal institutions on which this system is established. Innovation hardly takes place if social values and norms do not accept or reject new goods and services. For new things to emerge first changing attitude to them is required, which involves changing cultural norms.

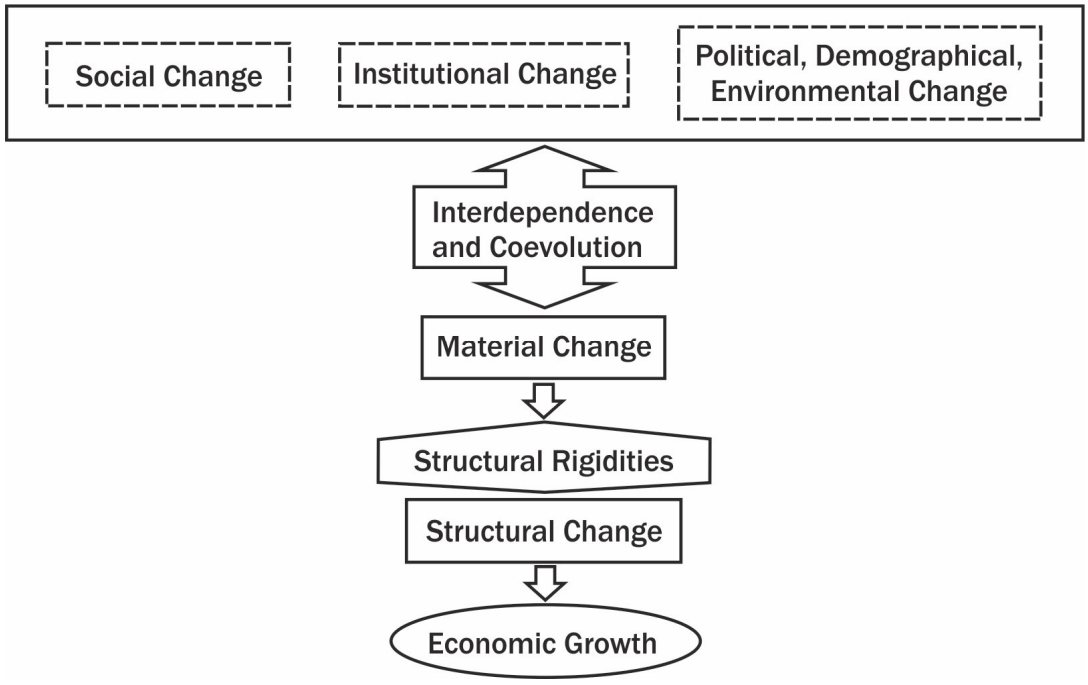
There could also be existence of lock-in mechanisms or social inertia, which results in either inability or unwillingness to change (Ahrne and Papakostas, 2001). Stagnant economies are not only stagnant structurally, they stagnant technologically, institutionally and socially. The scope of our paper does not allow us fully describe interaction between technological, institutional, social changes. Of course there also factors of demographic, political, environmental change, which put pressure on the structure of economy, but we do not include them in our discussion.

Structural change is mechanism which is necessary for economy to adapt its structure to technological, institutional, social and other changes. Structural change is a "complex, intertwined phenomenon" (Matsuyama, 2008) and structural adaptation to change requires significant degree of economic flexibility. Absence of structural change may have negative consequence for economic growth, since rigid or stagnant economic structures lead to misallocation of resources, thus flexibility of economic system is crucial factor facilitating structural change. There are numerous factors which can cause structural inertia or structural rigidity and impede resource allocation and hinder change and growth. Some of them are natural as labor market rigidity, capital market rigidities or formal institutional rigidities. There are systemic market distortions such as absence of competition, domination of monopolies, price distortions, rent-seeking behavior and protection of non-viable enterprises through mechanism of soft-budget constraints and weak absorptive capabilities of economy (e.g. lack of entrepreneurial abilities).

Development is continuing process of generation of change and adaptation to this change. The ability to adapt structurally to technological changes by reallocating resources to new activities is crucial factor which are essential for economic growth (Killick,1995).

Figure 7demonstrates how all elements of change interact in the process of economic change and result in economic growth. Economic change encompasses technological, social as well as institutional changes.

Figure 7. The Process of Economic Change and Mechanism of Economic Growth



4. SOCIALISM, TRANSITION AND CHANGE

The inability to sustain growth rates and chronical stagnation were the fundamental problems of the centrally planned economies. Western economists believed that socialist system was inefficient solely due to the problem of incentives effect of ownership of enterprises on technical efficiency. Murrell (1991) provides comparison of technical efficiency estimates of market and centrally planned economies. According to that comparison technical efficiency was not particularly a problem of socialist economies. Therefore only the incentives effect of ownership on technical efficiency cannot explain poor performance of socialist economy. When considering allocative efficiency, distinction should be made between static and dynamic allocative efficiency. Whitesell (1990) demonstrates that Soviet economic system shows "a surprisingly high degree of static allocative efficiency". However, he argues, that such performance "results from poor dynamic economic performance". Similar conclusion is made by Brown and Earle (2002). The price paid for efficient static resource allocation was slow pace of technological change. Indeed, centrally planned economies were dynamically stagnant and mostly because of stagnation in technological innovation. Slow pace of technological change resulted in slow pace of resource reallocation and as a result in slow structural change. Poznanski (1985) confirms that allocative mechanism of the central planning had strong effect on slow technological change in socialist countries compare with advanced market economies.

Centrally planned economies were fundamentally different from market economies in two aspects. One is the sources of innovation. Enterprises were not source of innovation, but only production units. Absence of competitive environment as selection process, absence of trial and error experimenting through market led to limited product variety and resulted in slow pace of product evolution. Another aspect is high degree of inflexibility of the mechanism of central planning. Centralized economic system was unable to timely adjust to technological innovation by changing its structure; structural inertia was distinctive feature of the system. Economic stagnation was not only structural and technological, but also extended to institu-

tional and social aspects. This presupposed very "curious concept of change" in socialist economies (Kovács, 1994), which was regarded as sudden and radical, rather than as a constant, steady process. For communist mentality change was as a single, one-off event, which then needed no further attention.

Since the beginning of transition many post-socialist countries, being in the middle income group experienced deindustrialization and shift of economic activity towards services, which is a feature of development of high-income countries. However such structural transformation was rather survival type, which is inefficient (Mickiewicz and Zalewska, 2002) and accompanied with stagnation in total employment (Havlik, 2005).At the beginning of transition Czech Republic was thought as successful example of structural transformation caused by transition reforms, however since the middle of 1990s, according to Flek and Večerník (2004), there was no further changes in the structure of employment. Constant rise in unemployment has had no consequences on the structure of employment.

Despite good pre-crisis growth performance, the ability of post-socialist economies to innovate has been questioned. Högselius (2003) notes that Eastern Europe countries have a severe lack of the ability not only to produce already existing goods and services but to generate new and improved advanced products. Kravtsova and Radosevic (2011) find that growth in Eastern Europe is driven by production, not innovation capabilities. According to Innovation Union Scoreboard 2013 and 2014 (European Commission, 2013, 2014) Eastern Europe countries belong to the group of moderate and modest innovators. In the process of convergence in innovation performance among EU members less innovative countries are no longer catching-up with the most innovative which may indicate on tendency to the a process of divergence in innovation performance. Narula and Jormanainen (2008) report that formal policies developed during transition period of Russian system of innovation have failed to create incentives for undertaking innovation activities and the modernization of industrial sector. Thus it was unable to overcome structural inertia. After 20 years of transition reforms entrepreneurial activity across transition economies still remains low. Estrin and Mickiewicz (2010) argue that this may be associated with the slow adaptation of informal institutions, including attitudes and social norms, as legacies of the socialist past.

These few facts demonstrate that inherited fundamental problems of the centrally planned economies have not been properly addressed by transition reforms and what is most important that lessons from the experience of the planned economy have not been learnt.

5. POLICY IMPLICATIONS

The objective of the preceding analyses was to demonstrate that policies facilitating sustained economic growth should be grounded on the premise of impossibility achieving sustained economic growth without continuous structural change and contributing to it qualitative changes. Our motivation to develop a broad framework was to highlight complexity of the mechanism of sustained economic growth and thus avoid simple-minded policy prescriptions. Such framework provides enough room for pragmatism in policy implications and allows suggesting specific policy measures.

Our framework should not be simplified to "growth through innovation" or "growth through entrepreneurship", because there is tendency to narrow the scope of these concepts. Innovation and entrepreneurship should be viewed in context of a broader category of change. Degree of innovation and entrepreneurial activity reflects more general attitude to change in a given society. Innovation takes place in socio-cultural context. We see that it is rather inappropriate to recommend for countries, where social or cultural norms are hostile to novelty and change to invest heavily in R&D.

Regarding transition reforms in the context of change we suggest that reforms of former socialist economies should be viewed as transition to change oriented culture. First, the process of transition can be viewed as process of creating capabilities to endogenously generate incremental continuous change.

The role of the state is to focus on policies which initiate, facilitate and sustain change. In our framework there is no separation between state and private, which allows a state to be initiative entrepreneur. This includes active role of the state in creating and shaping competitive market mechanism with focus on the unique role of entrepreneur as generator of change. McMillan and Woodruff (2002) emphasized importance of the coordinating role of the entrepreneur in transition economies which have flawed structures and a lower level of organization. Particularly, our framework highlighted importance of competition and entrepreneurship as generators of change, therefore creating competitive environment conducive to innovative entrepreneurship and entrepreneurial behavior of existing large firms should be a policy option.

Change is very complex socio-economic phenomenon. It is important to recognize interdependence and coevolution of society, institutions and technology. Perception of change is rooted in the values of society, which is reflected in persistence of informal institutions. Therefore policy may facilitate and direct evolution of informal institutions towards change oriented innovative creative culture, which would allow accumulation of innovative capabilities. Entrepreneurial abilities are not innate in anyone, in any culture; entrepreneurship itself is an element of individualistic cultures. Therefore policies may aim at creating entrepreneurial capacity through promoting entrepreneurial leadership.

We did not address policies which may facilitate structural change directly, such as industrial policy (technological policy), for the reason that industrial policy efforts under weak innovative capabilities may not be sustainable in the long-run. Although some state leadership might be necessary to initiate shift from activities with low potential to change (innovation and imitation) to activities capable to generate significant change. Of course, this should be considered in the context of institutional and social capabilities and degree of their flexibility. Removing structural rigidities would complement facilitating policy efforts. Some sectors, particularly resources sectors (agriculture or resources extraction activities) are inherently have lower potential to change. If most of economic activity takes place in such sectors economy may be locked in structural stagnation.

We can better define the destination of transition if we know more about functioning of advanced market economies. Market economy is complex mechanism, which cannot be reduced to private property and price system. In order to achieve continuity of change it is therefore required to make change a routine and objectives of transition polices is to enable mechanism which generates constant persistent change. Table 2 presents a comparison of traditional transitional and suggested post-transitional reforms in the context of change.

Table 2. Comparison of Transitional and Post-Transitional Reforms

	Transitional reforms	*Post-Transitional reforms*
Final destination of transition	Free market economy	Changing economy (technologically, institutionally, structurally, socially)
Goal	Improving technical (productive) efficiency	Improve dynamic allocative efficiency
Key subject of the study	Enterprises of manufacturing sector	Economic system as a whole
Policies	Liberalization and stabilization	Active structural transformation
Dominating approaches	Supply-side neoclassical economics	Market process, demand-side approach, evolutionary, economics, institutional economics
Market	Private ownership, self-equilibrating price mechanism	Origin of value, mechanism of dynamic allocation.
Incentives	Private ownership	Market competition
Indicator of transition	Degree of liberalization	Indicators of structural change, innovation

6. CONCLUSIONS

Transition, as well as economic growth and innovation, are not goals in themselves, and are not just mechanical processes, but all parts of very complex intertwined mechanisms of socio-economic change. We tried to connect those parts together into one conceptual frame-work of sustained economic growth.

Our paper brought discussion on issues which economic theory remains silent and those which were not properly addressed by transition reforms. Sustained growth requires sustained change. Sustaining change is equally important as sustaining productivity growth. The goal of transformation of post-socialist economies is to enable mechanism which generates permanent change. We can only say that transition is completed when the process of generation of continuous change is set in motion. Transition countries can catch up with advanced economies only if they can achieve and sustain the comparable pace of change.

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