



UNITED NATIONS
UNIVERSITY

UNU-WIDER

World Institute for Development
Economics Research

Research Paper No. 2006/17

Credit Co-operatives in Locally Financed Economic Development

Using Energy Efficiency as a Lever

Robert J. McIntyre*

February 2006

Abstract

In most transitional and many developing countries institutions capable of supporting economic development with localized saving-investment cycles have not developed. This crucial gap is in no way addressed by either country-level macro programmes dealing with ‘development finance’ or by donor-driven ‘micro credit’ schemes of Grameen and other types operating at a lower (local) level. The latter seldom evolve into financial institutions able to sustain themselves on the basis of local resources, do not operate on a sufficient scale to trigger dynamic local-level economic growth, and are ultimately artificial manifestations of concessional or charitable aid. The advantages of credit co-operatives in mobilizing and financing local economic development are .../

Keywords: development finance, local economic development, energy efficiency, credit co-operatives

JEL classification: O16, O18, P13, P52

Copyright © UNU-WIDER 2006

*Local Development in Transition (LDiT), and Department of International Economic and Political Studies, Economics Institute, Russian Academy of Sciences, Moscow.

This study is a revised version of the paper presented at the 17-18 June 2005 UNU-WIDER anniversary conference, ‘WIDER Thinking Ahead: The Future of Development Economics’, directed by George Mavrotas and Anthony Shorrocks.

UNU-WIDER gratefully acknowledges the financial contributions to the research programme by the governments of Denmark (Royal Ministry of Foreign Affairs), Finland (Ministry for Foreign Affairs), Norway (Royal Ministry of Foreign Affairs), Sweden (Swedish International Development Cooperation Agency—Sida) and the United Kingdom (Department for International Development).

ISSN 1810-2611 ISBN 92-9190-785-5 (internet version)

contrasted with the disadvantages of both conventional micro credit and the most recent neoliberal fashion of so-called 'new wave financial institutions'. Both precedent and the structural logic suggest that this is a promising space for the development of a localized financial system based on credit co-operatives, which elsewhere have overcome the SME credit famine and stimulated local saving-investment cycles. Recent Russian developments are placed in the context of earlier experience in structurally similar conditions. These lessons apply to all other former Soviet Union states, as well as other countries.

Acknowledgements

This paper further develops work done in the UNU-WIDER research project Small and Medium-Size Enterprises in Transition Economies, during 1998-2003. A feasibility study conducted in Russia during 2003-06 by Local Development in Transition (funded in part by the Ford Foundation grant 1245-2309), formed the basis for some of the research presented here, providing empirical examples and elucidating the conditions for success of credit co-operatives in this developmental role.

The World Institute for Development Economics Research (WIDER) was established by the United Nations University (UNU) as its first research and training centre and started work in Helsinki, Finland in 1985. The Institute undertakes applied research and policy analysis on structural changes affecting the developing and transitional economies, provides a forum for the advocacy of policies leading to robust, equitable and environmentally sustainable growth, and promotes capacity strengthening and training in the field of economic and social policy making. Work is carried out by staff researchers and visiting scholars in Helsinki and through networks of collaborating scholars and institutions around the world.

www.wider.unu.edu

publications@wider.unu.edu

UNU World Institute for Development Economics Research (UNU-WIDER)
Katajanokanlaituri 6 B, 00160 Helsinki, Finland

Camera-ready typescript prepared by Lorraine Telfer-Taivainen at UNU-WIDER

The views expressed in this publication are those of the author(s). Publication does not imply endorsement by the Institute or the United Nations University, nor by the programme/project sponsors, of any of the views expressed.

1 Overview

Outside dynamic and often prosperous-looking capital cities, most of the transition economies have not yet achieved broad-based and sustainable growth. A misguided chain of assumptions—that the small enterprise sector would by itself create successful economic growth; that individual private ownership was the only viable form; and that local banking services are best provided by large, usually foreign-owned, national units—have together wasted much time.¹ The major questions of large enterprise–small enterprise ecology and small and medium-sized enterprise (SME) financing, which are central to systems-level success, have been left largely unaddressed.

Earlier WIDER research shows that success of a ‘productive’ SME sector requires both active financial and non-financial support services at the local level and the survival, or revival, or development, of a healthy large enterprise sector. This paper focuses on the failure to develop institutions capable of supporting economic development with localized saving-investment cycles. This leaves a crucial gap, in no way addressed by either country-level macro programmes that deal with ‘development finance’, or by donor-driven ‘micro credit’ schemes of Grameen and other types operating at a lower (local) level. The latter seldom if ever evolve into financial institutions able to sustain themselves on the basis of purely local resources, do not operate on a sufficient scale to trigger dynamic local-level economic growth, and are ultimately artificial manifestations of concessional or charitable aid.

The advantages of credit co-operatives in mobilizing and financing local economic development contrast with the disadvantages of both conventional micro credit and the most recent neoliberal fashion of so-called ‘new wave financial institutions’. Both precedent (discussed below) and the structural logic of their situations suggest that this is a promising space for the development of a localized financial system based on credit co-operatives which elsewhere have overcome the SME credit famine and stimulated local saving-investment cycles.

2 Transition without sustainable propagation mechanisms

Most of these economies require but do not dispose of coherent local-level developmental policies, supported by national-level policy that allows room for constructive local initiative and a variety of ownership forms. Local and regional governments have a central role in stimulating growth of various types of business activity. The ‘local developmental state’ growth model implies a directly para-entrepreneurial role for local government (even including equity ownership), which is likely to be at least in part followed. In most of the transition economies this will require

¹ See McIntyre (2003).

creation of some kind of local finance system. The natural synergy between savings/credit co-operatives and production units with co-operative or partial employee ownership is evident in Nordic and other experience. Local government para-entrepreneurship and credit co-operatives are two among very few cases where 'advanced country experience' is directly relevant in much of the former Soviet Union and East Europe, but have still not been applied after 15 years of 'transition'.

It is important to link the mechanism to finance the foundation and expansion of small enterprises, based on localized saving-investment cycles, with measures to support local production in the face of the pressure of internationalization of the market. With the arrival in developing markets of large, well-financed foreign producers and distributors, even potentially promising local production capacities may be destroyed before finding their feet. Local producers may expire as a result of short-run 'predatory' tactics (penetration pricing, loss leaders, bribery of distributors or retailers, etc.) or loss of market access. Full-information approaches to labelling and non-tariff preferences for locally produced goods are possible local-level policy responses. It is especially important to maintain consumer access to locally produced goods when new distribution channels emerge. Locally rooted financial capacity is essential if this 'buffering' is to have sustainable developmental effects.

One particularly promising local government strategy is to combine the credit co-operative, local social sector and anti-poverty funding, and energy efficiency in a virtuous circle. In many parts of the former Soviet Union (FSU), especially outside the capital cities, urban populations remain dependent on centralized hot water and space heat systems in which there has been little attention to upgrading main thermal distribution systems and no systematic attention to improving efficiency at the block and building level. Energy efficiency is therefore a sector where local-level financing of small-scale local-level investment offers great potential to simultaneously stimulate SME growth, reduce energy waste and (by reducing the diversion of local social service budgets to pay for higher and rising energy costs) preserve funds for local health, education and welfare programmes. This combination is appropriate to most previously centrally planned economies and some other parts of the world as well.

3 Modest results at best for SMEs and local economic development, outside capital cities, in transition

Despite the tendency to think of and present the SME as an alternative to the former state-owned enterprise (SOE), except for the face-to-face retail and service delivery sector, little can be expected from the SME without either: (a) active support efforts at the local level; or (b) the survival or development of a healthy large enterprise sector which the SME can utilize as supplier, customer and provider of various social and technical externalities. If ways can be found to encourage the formation of purpose-built

alliances and sub-contracting relationships, positive and mutually reinforcing interactions can be expected to emerge.

Earlier research stresses the importance of developing productive local small enterprise systems that go beyond retail and traditional services and the centrality of locally rooted financial support mechanisms if there is to be any success in filling the still gaping (directly productive) small enterprise ‘black hole’ (McIntyre and Dallago 2003). The SME sector needs the large enterprise sector as a source of inputs, a market for its output and also (unexpectedly) as source of individual entrepreneurial leadership. This points to the need to create a synergistic relationship between the SME and the large enterprise sectors, not thinking of a zero-sum environment where success of the small can only be secured by destroying or disassembling the large. While the issues of the survival of larger entities (where they indeed exist) involve inherently national-level considerations, they also require correlate local-level initiatives.

4 Many examples of the merits of diverse organizational forms, policy approaches and financial mechanisms

There are real SME-stimulation alternatives based on actual developmental experience, taking the form of the *local developmental state* (Johnson 1982). This model has been pervasive in successful post-Second World War cases, from Germany, Austria and Italy to Japan, Taiwan, South Korea, and most recently China, but has been conspicuously absent from policy advice or practice in the transition economies after 1989. Bateman (2000, 2003) points out that virtually everywhere, national-level success in rebuilding and modernizing after the Second World War was heavily dependent on SME support measures, carried out as part of a national development strategy, but executed by local-level governments. And often provincial- or city-level banking entities have played an important role, either as government-owned entities or as co-operatives with strong government support and quasi-public duties. This experience should be well known, but is oddly invisible outside their home countries, even when the action bodies themselves (Raffaisenbank, various Landesbanken, Rabobank, Okopankki, etc.) are familiar participants in international financial markets.

4.1 TVEs are a new illustration of the local developmental state

One of the most interesting aspects of dynamic Chinese development after 1978 is the emergence of unorthodox ownership and governance approaches that form a distinctive ‘mixed property’ system. Barriers of culture, development level and political culture have made it convenient to not think carefully about the challenging and complex micro- and mezzo-level lessons of the Chinese experience, briefly discussed here.

The township and village enterprise (TVE) part of the system is in active, rapid evolution toward unclear future forms.² The remarkable success of Chinese local authorities as facilitators and direct entrepreneurs (para-entrepreneurial activity) perfectly illustrates the local developmental state conception (Johnson 1982) and is extremely important to other transition economies. The often excessive lending enthusiasm (and corruption) of many banks owned by various local government authorities should not deflect attention from the extent to which ownership, banking and quasi-planning of export-oriented development have been locally orchestrated.

Local authorities in some Central Eastern Europe (CEE) and Commonwealth of Independent States (CIS) economies face structural conditions that are similar in important ways (they bear effective responsibility for some local production and distribution, often have nearly identical ownership/partial ownership/effective ownership rights in some local goods- and service-producing entities in the face of the collapse of the economic leadership role of the central state and must deal with a stagnant local economy). Even in countries where privatization and market reforms have gone quite far, some structural carryovers from the planned economy remain. Local-level governments in transition economies are likely to remain economic actors on a scale generally greater than in long-time market economies, so getting better developmental effects from this activity is a vital task.

A key lesson of Chinese experience is that the original core TVE³ should be considered as a promising partial or sub-system model⁴ for other countries. Within this complex small town and rural mixed system there are strong elements of municipal socialism in which 'social' but non-nationalized property ownership plays an important role (Weitzman and Xu 1994). In what are essentially closed co-operatives, local government may either play only a supervisory and facilitative role or act directly as full or partial owner. The classificatory logic used by the World Bank treats all these variations as private sector development (no matter who owns it, if it is not the national government, the entity is considered 'private'), making this vital experience statistically invisible to most non-specialists.

Chinese institutional reforms and mixtures thus have unexpected local-level relevance elsewhere, especially once it is noted how strongly these new structures resemble the multi-owner partnership form that is widely successful in advanced market economies.

² Granick (1990); Sun (1997); Sun et al. (1999); Chi and Chou (2003).

³ Many existing TVEs changed legal form during the 1990s, becoming *joint stock co-operatives* or *joint stock partnerships* (Sun et al. 1999). This is sometimes little more than a name change, but large TVEs are thereby structurally prepared for the future possibility of becoming autonomous publicly traded entities. At the same time there was a sharp movement by purely private entities to take on this same legal form.

⁴ This is a partial model in the sense of constituting one of the organization types that could be included in a system, but not in being a universal model for all components of that system.

Stiglitz (1999) and others⁵ propose wide application of this aspect of the Chinese experience in other transition countries. How Chinese ownership will develop in the future is an open question, but many small- and medium-sized local SOEs facing or experiencing comprehensive reform and loss of national subsidies are likely to end up under township and local government control, taking the joint stock co-operative form with some degree of employee ownership. When TVEs move from full local government ownership to joint-stock co-operative form (with mixed local government and employee share ownership) they are indeed an example of what Stiglitz (1999, 2000) advocates as ‘privatization to stakeholders’. A similar category of employee-owned enterprises (*narodnaya predpriyatiya*) was established by 1998 Russian legislation and has interesting, but as yet unutilized, potential. It is structurally similar to Chinese joint-stock co-operatives and may eventually be able to include local government as partial equity owner (McIntyre 2001).

A combination these features could be useful in local-level revitalization efforts elsewhere, even though enormous regional differences in incomes and living standards and sharply increased inequality within regions pose a great threat to the continued success of this mixed model in China itself (Riskin 2001).

4.2 Finnish co-operatives and development policy

The Finnish co-operative tradition provides another useful point of reference. For over a century, Finland has used co-operatively-owned local-level financial institutions as part of a national-level economic development strategy (Kuisma et al. 1999). In 2005 one-third of all Finnish deposits and loans involve *Okopankki*, the capstone co-operative bank. The Finnish example is a provocative addition to debates about SME financing and suggests new tools to support market-based economic growth under sparsely settled, peripheral conditions found in much of the FSU and parts of CEE (Skurnik and Vihriälä 1999).

Finland has been astute and vigorous in pursuing complex and subtle industrial and developmental policies, while simultaneously appearing to the outside world to be practicing free-market rectitude. The banking sector is a case in point, where the success of the co-operative banking system traces back to tsarist period government (Grand Duchy of Finland) deposits (to overcome the initial trust and scale problems) and forming local banks into regional alliances under a national confederation, creating scale economies and assuring political visibility. Parallel to and with the support of co-operative banks, a wide array of production and marketing co-operatives arose. A century later they retain a large share (meat 71 per cent; dairy 96 per cent; eggs 60 per cent; forest owners 34 per cent; livestock breeding 100 per cent; retail trade 41 per cent; banking 34 per cent; insurance 8 per cent) of the contemporary Finnish market (Skurnik 2002). This type of active use of policy to create institutions is not unique to Nordic

⁵ Nolan (1995); McIntyre (1998); Stiglitz and Ellerman (2000); Ellerman (2005).

countries, but is especially strong there. As the *European Observatory for SMEs* notes, across the EU:

Many banking/credit/insurance co-operatives and mutuals have their roots in the co-operation of SMEs and the objective of providing auxiliary services to these enterprises. Co-operation is an important strategy for SMEs to strengthen their market position against larger competitors. In crafts, retail, trade, transport and some production, co-operative members are almost exclusively SMEs. [M]any [co-operatives] have been founded by and for SMEs and are, on the whole, SMEs themselves. (European Commission 1996: 351-2)

In many countries co-operatives operate in legal categories that are not explicitly 'co-operative'. This leads the *Observatory* to note that it is unexpectedly hard to judge the scale of operation by productive co-operative SMEs in the EU. Thus it is difficult to say how large the co-operative sector 'should be' by simple comparisons to other countries. It is nonetheless clear that combining co-operative saving and lending institutions with production, processing and service co-operatives makes good sense in many transition economies. The hundreds of 'new wave' co-operatives formed during the severe Finnish recession of the early 1990s are similarly promising. Many are technology and technical service companies, in the form of 'multi-branch work co-operatives' and 'single-branch expert co-operatives'. The linkage between these new co-operative forms and co-operative banking is both logical and straightforward.

National or local government engagement is generally required to start such savings and lending institutions, but is criticized as constituting an unproductive subsidy or unfair competition to commercial banks. On theoretical and historical-empirical grounds, Bateman (2000) has attacked the idea that market interest rates, combined with banking conventions about acceptable risk, answer all necessary questions about what is wise and developmentally viable in thinking about small enterprise support policies. Studies appraising differential SME access to finance within the EU reach the same conclusion:

The financial structure of an enterprise seems to depend more on the financial system and the financial habits of the country in which it operates than on any other characteristics of enterprises such as size, sector, age and even profitability. Moreover, the smaller the enterprise, the greater are the international differences in financial structure. (European Commission 2000: 19)

It is useful to consider the implications of these findings for the SME aspect of local economic development policy in transition countries, especially in light of the felt policy imperatives within the EU:

The efforts aimed at meeting the Maastricht criteria have substantially narrowed the room EU countries' governments used to have for

maneuvers in the field of SME policy. *This has not reduced the necessity to adopt new stimulating measures especially for SMEs and, in some case, has led governments to widen the scope of their enterprise policy.* (ibid.: 249-50, emphasis supplied)

This suggests that Finnish-style use of national policy to create conditions in which local-level saving, financial services, production, marketing, wholesale buying and other co-operatives take root, is directly relevant to solution of the puzzling failure of productive SMEs to play a significant role during the first decade of transition. The vast literature on the 'efficiency of worker-managed enterprises' brings former Yugoslavia to mind here, perhaps carrying with it doubts about the viability and efficiency of real co-operatives. Addressing exactly this concern, Hansmann (1996, 1999) and Stiglitz (2000) offer a bracing reinterpretation of the net efficiency advantages of co-operatives in light of new developments in agency and information theory dear to the hearts of all neo-classical economists.

4.3 Co-operative core bank plus business consultancy in Spain

While the Finnish (and other Nordic countries) co-operative approach to local-level enterprise finance and production reinforces the local developmental state conception and illustrates a highly successful solution to the pervasive SME finance famine, relationships like this can be found all over the world. An example is the role of the Lankide Aurrezokia Bank in the famous Mondragón system of locally-owned co-operatives in Spain, all of which were, and many of which remain SMEs. The core bank provides borrowers with technical and management guidance when needed and sometimes even moves employees between juridical distinct co-operatives in *keiretsu* style (Shuman 1998).

4.4 The French-Canadian Mouvement des Caisses Desjardins and the Caisses Populaires/Caisses D'Économie

Another example is Credit Desjardins and the associated Casises Populaires and Caisses D'Économie that form the largest element in the financial system of Quebec province, Canada. The co-operative development in Quebec was independent and in many ways unique, but has some rough similarities to the Finnish path. The Credit Desjardins movement began in the late 1890s after the formation of a government commission to study the causes of poverty and degradation in Quebec. The commission came to unexpectedly specific conclusions about the need to create local-level financing sources for decentralized development. This process occurred in the presence of knowledge about such developments in continental Europe and the UK, but it developed its own self-contained set of rules and structural approaches.

In Quebec the progression from small-scale testing of the ideas to rapid social acceptance occurred with extraordinary speed and large developmental effects. Credit

co-operative development in the USA proceeded by direct copying of Quebec approaches, rules and regulations, led by the Massachusetts legislature in 1908. The Boston department store magnate and philanthropist Joseph Filene stimulated this development. Filene followed the serendipitous path of first observing British-inspired co-operatives in India, drawing immediate conclusion about their appropriateness at home, and then finding a fully developed system growing rapidly ‘next door’ with a complete set of laws, by-laws and institutional structures, that required little more than translation.

The special contemporary interest in the Credit Desjardins approach comes from the rapid spread of this same style of organization in Russia, first in the south and now elsewhere in Russia under a development assistance programme financed by the Canadian International Development Agency (CIDA) and operated by the Développement international Desjardins (DiD) branch of the Credit Desjardins organization. This programme emulates, with culturally appropriate amendments, the approaches that were successful under structurally similar and extremely unpromising circumstances in Quebec and Finland, among others. LegaCoop (Lega Nazionale delle Co-operative e Mutue, in Italy), RaboBank (Netherlands), and Raiffeisen Bank (Austria), all co-operative banks, are further illustrations of the viability in the financial sector of divergent ownership, management and organizational arrangements.

5 Asymmetric opening: market access and other necessary protections for SMEs

The major problems of SME development—an inadequate institutional/organizational context, lack of product-market access for small-scale producers and most critically finance—are made worse by rapid, uncontrolled and asymmetric market opening that has occurred in all transition economies except for China, Viet-Nam and Slovenia. A recent UNCTAD (2002) study suggests that the process of opening up even well-established market economies has strong negative effects on the SME sector. The results could be even more negative in those (many) transition countries where an era of normal growth is yet to occur, magnifying vulnerability to outsiders. This reflects a mixture of the effects of initial domestic demand repression and the early arrival of more mature foreign competitors in all economic sectors. With the arrival in developing markets of large, well-financed foreign producers and distributors, even potentially promising local production capacities may be destroyed before finding their feet. Local producers may expire as a result of short-run predatory tactics (penetration pricing, loss leaders, bribery/black mail of distributors or retailers, etc.) or loss of market access.

A central but often invisible aspect of the survival or growth of productive SMEs is the ability to expose their products to the processes of consumer choice. It is especially important to maintain consumer access to locally-produced goods when new distribution channels emerge. Only a short period of exclusion from the market is enough to kill off otherwise viable and promising local production capacities. It is important to link financing of small enterprises based on localized savings and

investment cycles with measures to support local production in the face of the pressure of internationalization of the market. 'Full-information' approaches to labelling and non-tariff preferences for locally produced goods are possible policy responses.

Small-scale credit is obviously central to any successful cumulative SME development, but conventional micro credit approaches are not development-functional in the middle income, urbanized settings that characterize the bulk of the CIS and CEE. Based largely on grant funds and building no viable locally-owned institutions able to grow and evolve to a scale adequate to finance serious small enterprise development, they are at best viewed as a poverty palliative. Even in agricultural areas their long-term value is suspect because micro credit propagators often work to prevent the rise of alternative self-supporting credit institutions, such as real credit co-operatives. The enthusiasm with which various donors and multi-national institutions view the micro credit approach is not justified by their efficacy. Similarly doomed to failure is the recent enthusiasm for so-called 'new wave micro finance institutions'—commercially-oriented, competing, independent, financially self-sustaining lending bodies to deliver financial services to the poor and disadvantaged. This 'new wave' model quickly became a major local-level strand of the neoliberal development conception worldwide and

... has also attracted substantial political support and donor agency funding in the context of the reconstruction of southeast Europe in the wake of the Yugoslav civil war which ended in late 1995 and, more recently, in the aftermath of the Kosovo conflict of 1999 ... In some countries, such as Bosnia, the 'new wave' MFI model has effectively been the centre-piece of the international donor community's support for local economic development and poverty reduction. (Bateman 2003)

Like earlier misguided efforts to 'commercialize' business support services in transition economies, these new entities will almost automatically diverge from and ultimately abandon pursuit of the positive externalities that are the essence of successful local development efforts in all market economy environments:

It appears that the short-term benefits of this approach are largely wiped out by the negative effects of the associated economic policies that accompany it, including accelerated de-industrialization, rising trade deficits, declining state legitimacy and capacity, and the destruction of social capital. (Bateman 2003)

Dynamic economic growth that works for the poor regions and the poor nationally requires credit co-operatives and other forms of locally-owned banking institutions tasked with serving local small enterprise interests. Locally-owned banks and local small enterprise systems in various countries function successfully on 'social capital' that is very costly for large banks that have no inherent local development mission or mandate to acquire such expertise (Dallago 2003: 78-97). It does not make sense for

them to provide the type of patient, step-by-step credit and other financial service support that firms of a nascent small enterprise sector require.

Concern over the concrete local development effects is intensified when all or most local banks are absorbed by international banking companies. Once under foreign ownership local banks are very unlikely to devote significant resources to support foundation or growth of SMEs in areas where poverty is concentrated. The indebtedness and low profitability of the large banks that did retain their independence strengthened their inherited attitude of avoiding risky financing, requiring high collateral and charging high interest rates. In whatever form, the consolidation, restructuring, and privatization of large banks prevented the establishment and development of financial institutions for SMEs in most transition countries. The 2003 WIDER study⁶ concluded that these features of the credit market discouraged expansion and modernization but apparently not the foundation of SMEs.

6 Contingent policy advice or a (discredited) cookbook?

The point of these examples was to provide the basis for reflection on the following questions: why are reform/reorganization approaches so often suggested/imposed on transition countries in a 'cookbook' fashion. And why do the institutions proposed seldom reflect the variety that rules in existing successful market economies, but instead focus on institutional variants of distinctly Anglo-American origin (which even for those countries reflect an introductory text book simplification rather than the actual variety of forms extant there). The same point is to be made regarding fiscal policy (USA and one or more large EU states) and monetary policy (USA), where behavioral norms 'at home' diverge sharply from the restrictionist prescriptions offered to others. Exact parallels are also evident in all departments of social welfare policy.

While there is no simple answer as to what the recipients of advice and suggestions should do to reduce the damage caused by narrow and unrealistic recommendations, one approach would be to simply demand the discussion of alternatives in the certainty that there are some. A particularly useful point of reference is the research department of the World Bank that regularly produces (in Washington) results that can be used to challenge the policy advice delivered (from Washington) through the channel of the World Bank country office (Ellerman 2005). As the fashionable management analysis of Christensen and Raynor (2003) points out, management (and management reform) and policy (and policy reform) are inherently contingent processes, not amenable to one-size-fits-all solutions. What will work in a situation depends on careful analysis of the micro-, mezzo- and macro-level internally, as well as the external features of the concrete situation. This leads us back to conclusions about specific SME policies.

⁶ McIntyre and Dallago (2003).

7 Conclusions

A successful SME sector that goes beyond neighbourhood-level services and retail distribution (the latter often doomed in any case) requires both active support services at the local level and the survival, revival or development of a healthy large enterprise sector as supplier of inputs, output market, provider of various social and technical externalities, and also (unexpectedly) as source of individual entrepreneurial leadership. Systems success is more a question of quality than quantity, particularly concerning the interconnection of all the elements that form the economic system. SMEs are a crucial element, but policies that target the SME sector without paying attention to these surrounding conditions are unlikely to have substantial and long-lasting positive effects. Efforts to provide direct assistance to the SME sector often become mired in corruption, have high overhead costs and ultimately serve other-than-announced programme interests (Bateman 2000).

Local and regional governments have a central role in stimulating growth of various types of business activity. This includes creation of a local finance system based on credit co-operatives to overcome the SME credit famine and stimulate local saving-investment cycles, as well as directly para-entrepreneurial functions (including equity ownership), all generally consistent with the model of the local developmental state. The natural synergy between savings/credit co-operatives and production units with co-operative or partial employee ownership is evident in Nordic and other experience and is especially relevant in transition or post-transition economies. Even in countries where privatization and market reforms have gone quite far, some structural carryovers from the planned economy remain. Local-level governments in transition economies are likely to remain economic actors on a scale generally greater than in long-time market economies. Incomplete privatization often leaves local government with some de facto ownership rights, raising the possibility of development of something like the (early reform period) core-TVEs in China. At the enterprise level, various forms of full and partial employee ownership are appropriate, not excluding the local government as a possible equity co-owner. Pressures to reorganize units that provide municipal services into quasi-corporate ESCOs (Energy Service Companies), TSCOs, and so on, offer similar opportunities.

References

- Bateman, M. (2000). 'Neoliberalism, SME Development and the Role of Business Support Centres in the Transition Economies of Central and Eastern Europe', *Small Business Economics* 14 (4): 275-98.
- Bateman, M. (2003). 'New Wave Micro-finance Institutions in South-East Europe: Towards a More Realistic Assessment of Impact', *Small Enterprise Development* 16 (3): 176-91.

- Chi, R., and N.-T. Chou (2003). 'Small Enterprise Development: Evidence for China', *Small Enterprise Development* 14 (2): 48-55.
- Christensen, C., and M.E. Raynor (2003). *The Innovator's Solution: Creating and Sustaining Successful Growth*, Harvard Business School Press: Cambridge MA.
- Dallago, B. (2003). 'SME Development in Hungary: Legacy, Transition and Policy', in R. McIntyre and B. Dallago (eds) (2003) *Small and Medium Enterprises in Transitional Economies*, Palgrave Macmillan for UNU-WIDER: Basingstoke.
- Ellerman, D. (2005). *Helping People Help Themselves: From the World Bank to an Alternative Philosophy of Development Assistance*, University of Michigan Press: Ann Arbor.
- European Commission (1996). *The European Observatory for SMEs: 4th Report*, Office of Official Publications: Luxembourg.
- European Commission (2000). *The European Observatory for SMEs: 6th Report*, Office of Official Publications: Luxembourg.
- Granick, D. (1990). *Chinese State Enterprises: A Regional Property Rights Analysis*, University of Chicago Press: Chicago.
- Hansmann, H. (1996). *Ownership of Enterprise*, Belkap Press of Harvard University Press: Cambridge MA.
- Hansmann, H. (1999). 'Co-operative Firms in Theory and Practice', *Finnish Journal of Business Economics* 44 (4): 387-403.
- Johnson, C. (1982). *MITI and the Japanese Miracle*, Stanford University Press: Stanford.
- Kuisma, M., A. Henttinen, S. Karhu, and M. Pohls (1999). *The Pellervo Story*, Pellervo Confederation of Finnish Co-operatives: Helsinki.
- McIntyre, R. (1998). 'Regional Stabilization Policy under Transitional Period Conditions in Russia: Price Controls, Regional Trade Barriers and Other Local-level Measures', *Europe-Asia Studies* 50 (5): 959-71.
- McIntyre, R. (2001). 'The Community as Actor in and Incubator of Economic and Social Revival', *Local Development in Transition Policy Papers* 2, LDiT: New York.
- McIntyre, R. (2003). 'Waiting for Development: FDI, the Informal Sector and Poverty Reduction Policy', paper prepared for Eastern European Investment Summit, October, Bucharest.
- McIntyre, R., and B. Dallago (eds) (2003). *Small and Medium Enterprises in Transitional Economies*, Palgrave Macmillan for UNU-WIDER: Basingstoke.
- Nolan, P. (1995). *China's Rise, Russia's Fall: Politics, Economics and Planning in the Transition from Stalinism*, St Martin's Press: New York.

- Riskin, C. (2001). 'Decentralization in China's Transition', *Local Development in Transition Policy Papers* 4, LDiT: New York.
- Shuman, M.H. (1998). *Going Local: Creating Self-Reliant Communities in a Global Age*, Free Press: New York.
- Skurnik, S. (2002). 'Role of Co-operative Entrepreneurship and Firms in Organising Economic Activities: Past, Present and Future', *Finnish Journal of Business Economics* 51 (1): 103-24.
- Skurnik, S., and V. Vihriälä (1999). 'Role of Co-operative Entrepreneurship in the Modern Market Environment: Introduction and Summary', *Finnish Journal of Business Economics* 44 (4): 375-83.
- Stiglitz, J.E. (1999). 'Whither Reform? Ten Years of the Transition', paper presented at the *Annual Bank Conference on Development Economics*, April, World Bank, Washington DC.
- Stiglitz, J.E. (2000). 'Democratic Development as the Fruits of Labor', a paper presented at the Industrial Relations Research Association, Boston.
- Stiglitz, J.E., and D. Ellerman (2000). 'New Bridges Across the Chasm: Macro- and Micro-Strategies for Russia', mimeo, World Bank: Washington DC.
- Sun, L. (1997). 'Emergence of Unorthodox Ownership and Governance Structures in East Asia: An Alternative Transition Path', *Research for Action* 38, UNU-WIDER: Helsinki.
- Sun, L., with E. Gu and R. McIntyre (1999). 'The Evolutionary Dynamics of China's Small and Medium Enterprises in the 1990s', *World Development Studies* 14, UNU-WIDER: Helsinki.
- UNCTAD (2002). *The Least Developed Countries Report 2002: Escaping the Poverty Trap*, UNCTAD: Geneva.
- Weitzman, M., and C. Xu (1994). 'Chinese Township-Village Enterprises as vaguely Defined Collectives', *Journal of Comparative Economics* 18 (2): 121-45.