Neo-Liberalism, SME Development and the Role of Business Support Centres in the Transition Economies of Central and Eastern Europe*

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ABSTRACT. Support for SME development was one of the most important policy interventions initiated by post-Communist governments in Central and Eastern Europe from 1990 onwards. Substantial financial support for this was forthcoming from both the international assistance agencies and western governments. One major result was the formation of networks of Business Support Centres (BSCs). The design of the BSCs was very much informed by the neo-liberal approach to business development which was still in the ascendancy in the late 1980s. As a consequence, the BSC networks were structured to be private sector-led, financially self-sustaining, to involve minimal local government participation, and essentially pressed into focusing upon support initiatives which were consonant with short run market imperatives. With several years of experience now behind them, it is possible to begin to make an assessment of their operations and impact upon the SME development process. Unfortunately, the BSC networks almost everywhere are failing to deliver upon the heady promises of both their domestic and international supporters, and the SME development process is beginning to falter. Crucially, they compare very badly with previous historical episodes of SME development facilitated and co-ordinated by the local state. A new SME discourse is called for which explicitly recognises that a "local developmental state" approach could have a much greater, if not a pivotal, role to play in SME development in the transition economies.

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1. Introduction[1]

The transition process in Central and Eastern Europe is now into its second decade. This milestone has naturally given rise to much reflection on the efficacy of the policy interventions introduced to facilitate the conversion from communism to capitalism (see, for example, Business Central Europe, 1999). However, impetus for such reflection also comes from the fact that the transition is now increasingly seen as having been far less successful than was originally hoped (Amsden et al., 1994; Stiglitz, 1999), if not an outright calamity for the region (Andor and Summers, 1998). Transition policies utilised in Central and Eastern Europe were overwhelmingly framed and drawn up by the major international assistance agencies (principally the World Bank and IMF), western governments (especially the U.S. government) and by the consultancy companies and individual advisors contracted to assist with both the policy formulation and implementation of the reforms. Essentially, transition policy in Central and Eastern Europe was a textbook variant of the dominant radical free market discourse, neo-liberalism, which in the western economies in the 1980s had replaced Keynesian demand management as the supposedly ideal political-economic shell within which sustainable growth and development would be assured. However, the neo-liberal discourse was presented as the *only* possible and logical alternative to the previous highly inefficient system of central planning.

The neo-liberal discourse has extended to helping frame the majority of the SME interventions undertaken in the transition process so far.

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This approach very clearly precluded any active role for the state, and for SME policy interventions which abrogated the pure market mechanism. Crucially, the possibility of there being any "third way" between communism and capitalism, which might have involved varying degrees and forms of central and local state intervention undertaken against a background of market economic relations, was very determinedly resisted by the key parties to the transition policy formulation process (Amsden et al., 1994).[2] Yet, it is the case that state intervention, particularly at the local level, has played a pivotally important role in the post-war and post-crisis SME development successes of a number of the fastest growing and most successful countries since 1945; specifically, Japan, Italy, the former West Germany, the East Asian "Tiger" economies since the 1950s (particularly Taiwan) and China since 1980. From this rich experience an enormously successful SME development model can be distilled, based around the construction of a variety of inter-linking local state capacities, funding institutions, promotional agencies and regulatory functions. This model can be termed the "local developmental state", in contradistinction to the "market fundamentalist" model which was implemented in the U.K. and U.S.A. in the 1980s, and which was then heavily promoted in Central and Eastern Europe in the 1990s.[3] The "local developmental state" model should have had *major* implications for the transition economies, given that it emerged from the experiences of countries and regions which underwent huge systemic change, major cultural and attitudinal shifts, where new political regimes and structures were seeking legitimacy and popularity through rapid economic development and an increase in living standards, and where reconstruction and development had to take place against a collapse in economic activity – that is, the "local developmental state" approach succeeded in an environment very much the same as that which prevailed in Central and Eastern Europe after 1989.

This article examines the progress of one of the main SME policy interventions utilised in the transition economies since 1989, the networks of Business Support Centres (BSCs), which were envisaged to be the main driving force behind SME development. I start by outlining the progress made in SME development so far, before going on to examine the neo-liberal origins of the BSCs in order to point out the essentially ideological basis for their specific structure and *modus operandi*. I then explore some of the many problems which have arisen in the structure and operation of the BSC networks. These problems have effectively meant that the BSCs' contribution to SME development has been marginal at best, and may fade into nothing in the near future as their core funding from the international assistance agencies finally begins to come to an end. There is then a brief exploration of the possible alternative SME policy discourse which arises from previous historical episodes of post-war and post-crisis reconstruction and development. This alternative SME development discourse – the "local developmental state" approach – was avoided in Central and Eastern Europe for a number of reasons, which I then adumbrate at the end.

2. Background to SME development in the transition economies

The relative absence of SMEs was widely seen as a key factor which lay behind the poor performance of the majority of the planned economies in Central and Eastern Europe. Accordingly, once the decisive break with communism was made in 1989, SME development became one of the principal economic reform issues to be addressed by the post-communist governments throughout the region. The new governments responded by rapidly removing the main administrative barriers to entry, making quick work of the privatisation of the small-scale state enterprise sector, and undertaking at least some of the most basic reforms to the financial sector. Active labour market policies were also specifically directed to support the unemployed and soon-to-be-unemployed into small enterprises, in some cases becoming quite an important feature of labour market reform (OECD, 1996a). Western governments, particularly the U.S. government through its USAID arm, and the multilateral and bilateral development agencies (UNIDO, UNDP, ILO, GTZ, the U.K. government's Know How Fund, etc), were quick to offer financial and technical support for SME development. A new bank, the

European Bank for Reconstruction and Development (EBRD), was also established to support private sector development. The European Union emerged as the most important provider of assistance for SME development, in the shape of its Phare SME support programmes which were introduced in the early reforming countries of Central and Eastern Europe from 1990 onwards. For example, through its Phare SME programmes, the EU contributed over 320 mn Euro between 1990 and 1993 alone (Phare, 1994) and just less than this amount in the two year period 1994–1996 (Phare, 1997a). Later on the EU's support for SME development was extended to the former Soviet Union through the TACIS programme.

The apparent result of the immediate liberalisation of the business environment, and the coming on stream of the multitude of support programmes, was that the SME sector experienced a major boom. Indeed, after nearly ten years of the transition, and set against a background of abject failure in many other areas of the reforms in Central and Eastern Europe (see Stiglitz, 1999), the growth of the SME sector is now widely pictured as one of the main success stories in the move to the market economy (Levitsky, 1996; OECD, 1996b; Zecchini, 1997). In all of the transition economies the SME sector now accounts for a very sizeable share of employment, output, tax contributions, consumer goods supply, wealth creation and overall growth. SMEs have facilitated the introduction of a wide range of new technologies, managerial techniques and innovations (Dyker, 1997). They have also undoubtedly led to a new entrepreneurial business culture starting to take root in Central and Eastern European society, which is beginning to affect both small and large enterprises alike as it gains ascendancy over the old "bureaucratic-administrative" business culture (Bateman, 1997a). Moreover, given the absence of a properly functioning social safety net in many post-Communist economies, SMEs – particularly the smaller informal and micro-enterprise variety – have clearly played a role as a source of primary or secondary income for many who would otherwise be experiencing grinding poverty (ILO, 1995; MCS, 1996).

However, in spite of there having been progress over the last decade or so, on closer inspection a significant part of this progress in the SME sector is actually shallow and illusory. For a start, many new SMEs have been created from the break-up of larger inefficient state enterprises,[4] and from the mass privatisation of smaller units such as retail outlets (Frydman et al., 1993). The addition to output represented by these new SMEs is thus very largely offset – at least quantitatively – by the reduction in output of the larger enterprise, or else captured by the simple statistical change in the origin of output, moving from the state sector category to the private sector one. Many new SMEs are also simply conversions from the unofficial sector which, in many of the Central and Eastern European economies, had become a major feature in the 1980s (Patterson, 1993). It is also very clear that in each of the transition economies the official statistics vastly overstate the numbers of, and levels of employment in, the SME sector.[5] As Table I indicates, many see a clear gap between the number of registered enterprises and the number estimated to be actually functioning.

It is also clear that many of the new generation of post-Communist entrepreneurs and SMEs are enjoying success only because, against a background of a collapsing state industry sector and the evaporation of most of its previously comparatively well paid and secure employment opportunities, they are able to find employees willing to accept poor remuneration, job insecurity, a non-union workplace,[6] and "sweat-shop" working conditions (Hardy and Rainnie, 1996). Worse, in many cases the capital realised under such anti-social conditions has been invested in property speculation, conspicuous consumption or sent abroad, rather than being used to finance the gradual move into higher-value added production which would strengthen the enterprise in the longer run, and thus benefit both employer and employee. This was especially the case in Russia and other countries of the former Soviet Union (Iudanov, 1994, pp. 55–68).

But what is of perhaps most concern for the longer term, sustainable development trajectory of the SME sector in Central and Eastern Europe is the fact that most active SMEs are principally engaged in petty services and simple arbitrage, and small-scale retailing and importing activities, with the corollary that very few are seriously engaged in manufacturing activity involving meaningful

TABLE I
Estimated number of small and medium firms in CEE countries in 1995

Country	Registered firms	Number active[a]	Number of small firms[b]	% age of small firms	Number of medium firms[c]	% age of medium firms
Albania	41,460	29,000	300	1.0%	100	0.25%
Bulgaria	302,665	189,000	2,900	1.5%	700	0.33%
Czech Republic	706,495	441,000	13,300	3.0%	2,300	0.5%
Estonia	60,000	30,000	1,500	5.0%	300	1.9%
Hungary	519,502	332,000	8,300	2.5%	2,700	0.8%
Latvia	57,300	25,000	1,000	4.0%	300	1.0%
Lithuania	57,078	27,000	1,100	4.0%	300	1.0%
Macedonia	49,517	31,000	500	1.5%	200	0.5%
Poland	1,057,102	507,000	25,400	5.0%	7,700	1.5%
Romania	362,662	226,000	6,800	3.0%	2,300	1.0%
Slovakia	187,710	122,000	2,500	2.0%	900	0.7%
Slovenia	72,387	54,000	2,200	4.0%	1,100	2.0%

[a] Estimates made by the authors (Phare, 1997b); [b] 10–49 employees; [c] 50–249 employees.
Source: Eurostat, quoted in Phare, 1997b, Appendix 3.

capital investment and new technology. There has been a pronounced "too small – too weak – too isolated" trajectory (Arzeni, 1996; Bateman, 1997b; Smith, 1998). Major local financial sector "crowding out" effects are largely responsible for this trend, a situation quite familiar to many LDCs in the throes of structural adjustment and increased marketisation (see, for example, Stewart et al., 1990).[7] One result of this "crowding out" effect is quite clearly the dearth of small-scale manufacturing industry: the vast bulk of active registered enterprises – over 80% – are micro-enterprises employing no more than one or two workers, while over 70% of active enterprises are in petty services of one kind or another – retailing, transport, catering, importing (Phare, 1997b). The relative absence of a strong SME sector *vis a vis* the booming micro-enterprise sector and the still important large (state- and increasingly privately-owned) enterprise sector in Central and Eastern Europe, as shown in Table I, is often described as the "hollowing-out" of the industrial structure (Bateman and Lloyd-Reason, 2000).

The "too weak – too small – too isolated" phenomenon is one of the most problematic aspects of the SME development trajectory in Central and Eastern Europe. This is because such a structure is unlikely to generate the most important positive development externalities in the local economy which inevitably underpin the positive growth of both the SME sector, and thenceforth the local, regional and national economy. A weak SME sector is unlikely to lead, *inter alia*, to inter-enterprise networking, subcontracting, exports, technology transfer, a local R&D culture, local product and process innovation, high quality training institutions, and so on. On the contrary, almost without exception the most successful models of small enterprise development, particularly those which involve extensive inter-enterprise linkages and SME clustering, place a very high premium on SMEs as sophisticated manufacturers, advanced industrial service providers and high quality industrial subcontractors (see Weiss, 1988; Porter, 1990; Pyke and Sengenberger, 1992; Nishiguchi, 1994; Cooke and Morgan, 1998; OECD, 1999).

One factor behind the essentially shallow nature of the progress made so far in Central and Eastern Europe is the structure and extent of the policy support which came on stream from 1990 onwards. The most expensive and highly visible form of international support for SME development in the transition economies has been the promotion and financing of Business Support Centres (BSCs).[8] These local promotional bodies, and variants thereof, were an important form of support for SME development in the western European economies, and they are widely seen as having played an important role in the apparent rebirth and deepening of entrepreneurship and SME development which has taken place there in the 1970s and 1980s (Pyke and Sengenberger, 1992; Cooke and Morgan, 1998). It was thus to be expected that BSCs would also be heavily promoted in Central and Eastern Europe. Indeed, the establishment of BSC networks became one of the main SME-related tasks undertaken by most of the first post-Communist central and local governments, the overwhelming majority of them being financed by the international community (Phare, 1994; Levitsky, 1996; UNIDO, 1997). As in the western European countries, the BSC networks were meant to provide, firstly, very basic business advice and support for new start enterprises, potential entrepreneurs among the unemployed, small growing enterprises, and SMEs in minority and disadvantaged communities. Countering the expected rise in unemployment was a major aim of the BSCs, and this led to many BSCs being deliberately established in regions already experiencing, or expecting to experience, particularly high unemployment. Secondly, the BSCs were also expected to act as the main local engine for SME development, one aspect of which was to promote the general local institutional, regulatory, legal, taxation and financial environment in which a local SME sector could become established and grow. Essentially, they were supposed to develop into strong and pro-active agencies which could underpin SME development into the future, which effectively meant in practice "after the international assistance agencies had withdrawn".

3. The ideology underpinning the BSCs

The theoretical foundations for the strategy and operations of the BSC network were very much drawn from the key tenets of neo-liberalism, which by the 1970s and early 1980s had become the most influential political project in both the developing economies (Colclough and Manor, 1991) and in the majority of the western democracies (Amin and Tomaney, 1995). Neo-liberalism was most closely associated in the developed economies with the radical free market policies of Margaret Thatcher in the U.K. and Ronald Reagan in the U.S.A. Its adherents see a strictly limited role for the state in economic development, believing that market forces alone are sufficient to articulate and support an economy to develop in an economically optimum and socially sustainable manner. By the late 1980s, however, the neo-liberal project was becoming increasingly associated in practice with unfavourable economic performance, widespread inequality and a deterioration of the social fabric (see, for example, Liepitz, 1992; Peck and Tickell, 1994; Cowling and Sugden, 1994; Sennett, 1998). Notwithstanding this poor progress (particularly so in the country most associated with neo-liberalism's genesis – the U.K.), the neo-liberal agenda was highly influential in informing the transition strategies adopted by governments in Central and Eastern Europe from 1989 onwards (Marquand, 1990; Sachs, 1990; Gowan, 1995: Andor and Summers, 1998). Not surprisingly, the range of micro-economic interventions, including SME development policy, came under the influence of the neo-liberal agenda. At its root, the neo-liberal approach to SME development essentially conflates slavish respect for the activities and freedoms of the individual entrepreneur (best exemplified by the "enterprise culture" promoted by the Thatcher administration in the U.K.), with the wholesale acceptance of Chicago school textbook models of perfect competition and their explicit hostility towards all forms of collective endeavour and state intervention. Following Hayek (1944), entrepreneurs are seen as the main wealth generators in society: it is their unfettered freedom to do what they do best which results in progress and economic development, and any form of state intervention or regulation of their activities is therefore, by definition, counter-productive. It follows that the state should refrain from "interfering" in the economy, and simply work towards ensuring a neutral competitive environment, property rights and the rule of law. However, owing to the especially deleterious market conditions prevailing in early post-Communist Central and Eastern Europe, a number of explicit SME development interventions were in the end considered necessary, including the establishment of networks of BSCs. Neo-liberal imperatives were nevertheless considered appropriate to the design of the BSCs, viz;

- financial sustainability – the BSCs were expected to avoid becoming dependent upon long term budgetary support from government (central or local) in line with the transition policy imperative of reducing the role and cost of the state (see Rama, 1999). Heavy emphasis was therefore put on (eventually) commercialising the BSCs' services in order to generate fee income;

- short-termist – the BSCs needed to show quick results to the donor community, and thus ensure continued financial support in the short to medium term in competition with other donor-funded projects. In addition, a longer term focus suggested an element of "planning", which was anathema to both the donor community and many host governments;
- private sector-led – the BSCs were structured to have strategic and operational independence from government, and to adopt a strongly commercial approach under the guidance of private sector representatives and/or lobby groups. Local government was structured to be (only) a "stakeholder" in its local BSC;
- market-driven – the BSCs were structured to respond to the basic and immediate business needs of new and existing SMEs, and to accept prevailing local market forces (particularly market prices) as given. This effectively removed any notion of there being (local) planning or state intervention to develop the SME sector.

4. The practical experience behind the BSCs

The practical inspiration for the majority of BSC networks in Central and Eastern Europe was quite clearly the United Kingdom's experience with Local Enterprise Agencies (LEAs) and Training and Enterprise Councils (TECs).[9] The U.K. LEAs were established from the late 1970s onwards as private-sector led, non-profit business support bodies which were initially intended to rely on funding from local private industry (especially, in the early 1980s, from those large companies making large-scale redundancies), central government, and support from local government (sometimes in kind, such as redundant property) (Morison, 1987; Deakins, 1996). They were joined in 1988 by over 80 TECs, which were to operate as the main providers of a range of business support services which had previously been undertaken by local offices of central government ministries (Curran and Blackburn, 1994). A key initial feature was that the central government channelled funds earmarked for small business support through the TECs, which in turn invited the LEAs to bid for the financial package to undertake a particular range of support services for local small enterprises. In effect, the responsibility for the delivery of business support services was being "privatised" (Moore and Pierre, 1988) and a "quasi-market" for their delivery was being constructed (see Bartlett, 1995). Later on, as central government spending began to sharply contract under the Thatcher government, and when it also became clear that private industry was quite unwilling to provide the requisite financial base, the concept of user-charges was increasingly promoted to underpin the revenue structure. This development was to have been expected, however, since the principles of full-cost recovery were making significant inroads into virtually all traditional local government services in the U.K. (e.g., transport, education, waste removal, health care, leisure services). These traditionally public sector services were being recast as private sector operations in order to extend the market into every possible corner of everyday life (Le Grand and Bartlett, 1993). Accordingly, the new entrepreneurship initiatives introduced in the early 1990s, such as Business Links, were at the start very strongly exhorted to become self-financing (Devins, 1996).

It is important to emphasise that the U.K.'s LEA/TEC public-private partnership model of business support services arose not so much because it was seen as the best way to create a comprehensive, responsive and sustainable SME support network: rather, it reflected the then Thatcher administration's over-arching ideological mission to reduce the role and cost of the state. This strategic goal was considered at least partly attainable through the promotion of private sector solutions to every possible social, economic, business, educational and cultural requirement in everyday life. It was to be operationalised through a "commitment to privatisation, deregulation and the introduction of commercial criteria into any residual state activities" (Jessop et al., 1988, p. 171). In terms of SME development specifically, the goal was to be achieved by devolving as much responsibility for SME promotion as possible down to various self-help bodies in the community, which were to be financed locally and driven by the private sector. Where central government support was still required for the time being – the aim was that local self-help would replace government spending in the long run – it should be allocated on the basis of competition between individual units operating within the SME support infrastructure.[10]

The LEA/TEC model also played an important function within the neo-liberal labour market restructuring programme pursued by the Thatcher administration. This was to encourage the increasing population of unemployed to learn to accept the discipline and full rigour of the market, and therefore be more willing to work at lower wage rates, or consider self-employment at lower levels of financial reward. To achieve this goal required that very often the most marginal forms of employment and self-employment were given more emphasis. For instance, training in the TECs was low-level, of a short duration (typically six months) and generally reflected the shifting requirements of local low-wage employers having the most difficulty recruiting in spite of high local unemployment (Peck and Jones, 1995). To encourage high rates of take-up in what were overwhelmingly low quality training programmes, new powers were introduced which allowed for welfare benefits to be withdrawn for those who failed to participate as requested (Finn, 1988). Overall, it is clear that the U.K.'s LEA and TEC initiatives were, in fact, part of a centrally imposed, but locally implemented strategy to usher in local variants of the U.S.-inspired "workfare state" model, at a time when it seemed politically imprudent to do this at the national level.

5. The BSCs in practice

It was thus reasonably clear what the international assistance community initially considered to be the preferred model for a BSC in Central and Eastern Europe. It was pioneered in Hungary in 1990, and given substantial pump-priming support from the EU's Phare SME development programme (Phare, 1994). The drive to use the U.K.'s LEA model in the Hungarian context was initially provided by the EU's officials, who had to work within the explicit neo-liberal framework which guides the overall process of European integration, and thus animates the bulk of the EU's economic development strategies and operations (see Amin and Tomaney, 1995). However, many of the international consultancy companies contracted by Phare to implement the SME support programme considered the U.K.'s LEA model to be "best practice".[11] In the Hungarian case this meant the consultancy arm of U.K.-based Coopers and Lybrand (now known as PricewaterhouseCoopers). Having significant experience in implementing and evaluating the LEA/TEC bodies in the U.K., with neo-liberal cardinal principles dominating the approach to business development in the U.K., and with neo-liberalism very clearly the agenda of those western governments and international assistance agencies financing the transition (and, of course, the consultancy contracts which this entailed), the LEA model was a pretty obvious choice for the U.K. advisors to make when entering the new market of Hungary and the wider post-Communist Eastern Europe.

The LEA network in Hungary was established under the auspices of the Hungarian Foundation for Enterprise Promotion (HFEP), an independent body established by the Hungarian government, business associations and the banks. The HFEP was specifically intended by both the government and the European Commission to be the implementing agency for the Phare programme. It had to link upwards with government and responsible Ministries, and downwards to the LEA network. The LEAs themselves were established as non-profit-making bodies, with representatives of local government and other interested private and public sector bodies constituting a managing board. As Non-Governmental Organisations (NGOs), the LEAs were effectively placed alongside the myriad of other NGOs competing for donor assistance, though it was planned that central and local government would financially assist them when Phare funding came to an end.

With some changes and adaptations to take into account local conditions, essentially this model became the conventional wisdom for most of Central and Eastern Europe. As in Hungary, many local governments quickly realised the way the wind was blowing and so helped to establish the sort of BSC which they knew would attract international financial support, at the same time hoping that some of this financial support would find its way into their activities. In some cases this model encountered local resistance, but the international assistance agencies generally tended to get their own way. For example, the Hungarian government initially indicated some preference for international assistance to be channelled through the Chambers of Small and Medium Sized Enterprises linked to the Hungarian Chamber of Commerce (UNCTAD, 1993). But this came to nothing. In Slovakia, small enterprise support was initially channelled through the regional development departments located within district government offices, but heavy pressure from western consultants to build private sector-led institutions was ultimately successful (Smith, 1996). In Slovenia, the EU's Phare programme officials refused to support the Slovenian government's plans for a comprehensive network of state-led local SME support institutions, strongly arguing instead for private sector-led institutions (Phare, 1996).

What have been the consequences of this neo-liberal inspired business support services model so far? We would argue that there are six key problematic issues which have significantly held back SME development to date, and which bode ill for the future of the entire SME development trajectory.

5.1.

It is clear that as the international funding comes to an end the BSC networks in almost all Central and Eastern Europe countries are deteriorating rapidly, and in many cases are near to collapse. In some cases individual and groups of BSCs have actually ceased operations just before, or just after, the international funding ran out (Court of Auditors, 1998). In other cases, the international assistance agencies have had to extend their financial support under duress, or else see their creations very quickly collapse. Independence from government has very definitely not led to sustainability. Almost everywhere in Central and Eastern Europe there has been a persistent shortfall of central and local government financial support for the BSC networks. There are several reasons for this. First of all, there has been substantial domestic and international pressure upon central governments throughout the countries of Central and Eastern Europe (principally coming from the IMF and World Bank) to reduce their activities and spending (see Rama, 1999). However, although many central governments have been reluctant to help because they were genuinely short of cash, it is also clear that those governments which have most resisted offering financial support are also those which most fully bought into the neo-liberal notion that the "invisible hand" was really all that was needed for entrepreneurship to flourish.[12] Some central governments also came to resent the fact that they were expected to eventually accept responsibility for the financial upkeep of the BSC networks, without having had sufficient influence over how these networks were designed or implemented.

Second, local governments have generally tried to be more supportive of SME development. But they also resist offering anything more than token support to an institutional structure which they rightly perceive to have been deliberately designed to reduce their role and scope for local economic intervention, and which was very clearly meant to be driven by the local private sector right from the start. Moreover, as the de-centralisation of the state gathers pace in the post-Communist period, local governments have also had to work within the double constraint of reduced subventions from the centre coupled to an increased area of responsibility (Bird et al., 1995). This situation has naturally undermined local government's ability to retain many important activities and responsibilities (e.g., health care, social services), and thus it has naturally also made it very difficult for them to justify any deepening of their economic support role and SME development responsibilities. It is not surprising, therefore, that hardly any of the local governments in the transition economies have been able to carve out sufficient budgetary resources to fully underpin the SME development process through the networks of BSCs. Most local government's are willing to donate a municipal building for a BSC to use without charge for a period of time, but this is often all that they can invest. Moreover, even though in most localities local government has a "stake-holder" involvement in SME development, this has rarely proved to be enough to ensure sustained funding, if indeed it has not made the situation worse because of the fact that a situation of responsibility without power has been created. As UNIDO was forced to report (1997, vol. 1, p. 20), "Merely having representatives of "stakeholder" agencies on the board of local or national enterprise development institutions does not solve (the sustainability) problem *and indeed may exacerbate it*" (my italics). Hungary is considered to be one of the most successful of the transition economies, yet its local government structures had to signal that they were unable or unwilling to come up with sufficient budgetary support to allow their respective LEA networks to remain in operation after Phare's planned pull-out in 1994–1995. This required urgent action by the Phare programme, which had till then supported the establishment of the entire network of 20 LEAs and associated sub-offices, in order to come up with a plan for the LEA network's survival (RIPA International and MACON, 1997). Finally, relying on corporate largesse to finance BSC services has proved to be particularly difficult: there are very few examples of large companies offering very much support to BSCs.

5.2.

As a result of the deficit of central and local government support and absence of private sector sponsorship, a major effort is now underway across the transition economies to hurriedly transform the majority of BSCs into straight-forward commercial bodies capable of competing for fee-paying work with their counterparts in the private sector. This re-positioning move is quite open and, indeed, has provoked intense debate as to how best it can be carried out. It was, for example, one of the themes of a major conference organised by the Central European Small Business Enterprise Development Commission (CESBEDC), a body which was established by the U.S. Congress in 1990 to assist with enterprise development in Central and Eastern Europe. The conference concluded that, ". . . a Center's director and associate director should spend a considerable amount of their time on marketing, through *direct personal calls* on businesses and government agencies that may want the Center's services" (Fogel et al., 1995, p. ix). Not surprisingly, some of the first BSCs to move in this direction were indeed the U.S. government's Small Business Development Centres in Hungary and Poland. As U.S. government funding began to come to an end these BSCs were very rapidly converted over to become revenue-generating bodies (Pricer and Blackman, 1995). Other examples of this include the UNDP/ILO BSC established in Razlog in Bulgaria, which has been forced into exploring any avenue towards sustainability, while the BSC established by USAID in Stara Zagora, also in Bulgaria, was also undertaking any business activity to survive, though it was pinning most of its hopes on the arrival of financial assistance from the German government (interview, National Agency for SMEs, Sofia, 1998). Very many of the TACIS supported BSCs in the former Soviet Union appear to have done the same thing. Although some TACIS BSCs have simply closed down after their funding stream ended, many more in the Russian Federation, Azerbaijan and Kazakhstan have reacted by moving quickly into consultancy activities with the largest companies, particularly with regard to privatisation and Joint Venture (JV) advice and assistance (author's interviews with TACIS SMEDA staff in Russia, Kazakhstan and Azerbaijan undertaken between 1996–98). There is no reason to think that the situation will be any different in the other parts of the former Soviet Union.

The EU's Phare programme of support for SME development has probably supported the largest number of BSCs into operation in Central and Eastern Europe since 1990. And as the EU makes ready to cease funding the networks of BSCs which it has created, its BSC networks are thereby being forced into very heavy involvement with commercial revenue-generating activities. This work is very often with local large private enterprises, incoming multi-nationals, and increasingly with large state-owned enterprises and public services bodies. The EU Phare BSCs everywhere are being implored to increase the SME community's awareness of their commercial services and their "special qualities" as service providers, such as in the Czech Republic where the Regional Advisory and Information Centres (RAICs) and Business Innovation Centres (BICs) are now under enormous financial pressure after Phare support came to an end in 1998. The RAICs have thus been working hard to develop consultancy business in any field in which they may be able to develop a commercial competence (Phare Report No. R/CZ/SME/9701, 1998). In Slovakia, the EU's Phare supported RIAC and BIC networks have also been pushed towards a major re-structuring and commercialising exercise since 1996, in order to offer some hope for their survival after Phare's withdrawal (Thompson and van der Horst, 1996). In Poland, the EU fully supported 33 BSCs until the end of 1995, before moving to provide contractual support to the entire BSC network of 126 BSCs through competitive tender procedures. Those BSCs able to win access to further support have so far been able to continue and count themselves lucky to have won some breathing space to develop alternative sources of funding. But those BSCs which failed to win anything in the round of Phare contracts so far have been forced to move into virtually any area of business in order to survive, and it is envisaged that many will simply not survive (information supplied by the Polish Foundation for SME Development, 1998). In Bulgaria, the EU Phare programme established five BSCs from 1991 onwards with a modest amount of pump-priming cash, but by 1996 all were barely surviving by providing a broad mixture of business advisory services to any firms or individuals willing to pay, providing training programmes funded by other international donors and contact-making. In Hungary, as early as 1991 Attwater (1992) was able to report that that the LEA in Szabolcs-Szatmar-Bereg was getting very heavily involved in a wide-range of entrepreneurial activities, but many of these activities were only tangentially related to the core activities of SME support. This trend pioneered in Szabolcs-Szatmar-Bereg has continued to date. Since 1994/95 all of the Hungarian LEAs have come under increasing pressure from the EU and the Hungarian Foundation for Enterprise Promotion (HFEP) to develop further their income-generating activities involving the business sector *as a whole* (i.e., not just SMEs) in order that they have a chance to survive after Phare and other international agency funding comes to an end (RIPA International and MACON, 1996).[13] However, this pressure to move towards commercialisation is evident throughout Central and Eastern Europe. Originally a point which was most explicitly stated with regard to the Hungarian LEAs – the first and supposedly the best of the BSCs in Central and Eastern Europe – effectively it is now the conventional operating methodology for all of the BSCs now facing the end of Phare funding (RIPA International and MACON, 1996).

Many BSCs have also opportunistically restructured themselves into Regional Development Agencies (RDAs) in order to tap into the flow of EU funds expected from the pre-structural funding cash associated with EU accession, and thus save themselves that way. While undoubtedly some BSCs may well have certain skills and experiences to offer in terms of implementing regional development initiatives, their motivation to get involved would overwhelmingly appear to be financial. This has been the case in Bulgaria, for example, where the RDA "franchise" is seen as a major financial life-line, resulting in most of the current BSCs striving to obtain it in order to survive. Several BSCs have been successful to date (interview, Bulgarian Association of Regional Development Agencies and Business Centers (BARDA), September 1998). In Slovenia, the RDA brief has been successfully incorporated into the current activities of several early BSC projects, for example in Zagorje and Kranje (Phare, 1996). The LEAs in Hungary have been strongly encouraged to bid for the RDA "franchise" format prior to the arrival of EU structural funding. There has, for example, been a proposal that the LEAs eventually merge with the newer County Development Councils (CDCs), which were established in 1996 *inter alia* to provide a channel for EU Structural Funding, and thus create a network of more integrated Regional Development Agencies along the lines of the EU model itself (Phare, 1997c). Most LEAs are keen to go down this route, though such conversions are certainly not clear cut by any means: for example, the very successful LEA in the northern region of Szabolcs-Szatmar-Bereg has been involved in a long-running and acrimonious dispute with its local municipality over which institution has the "right" to operate the county's RDA (interview, "PRIMOM" (Szabolcs-Szatmar-Bereg LEA), November 1998).

Overall, therefore, it is abundantly clear that BSC staff everywhere are now increasingly and routinely being encouraged to spend a large proportion of their time touting for virtually any sort of fee-paying activity on offer, irrespective of whether or not this involves working with the SME sector.[14] Thus, those BSCs which are set to survive into the future are doing so by becoming indistinguishable from conventional private sector consultancies, which means that the BSCs are now, essentially, mainly concerned with their own profitability and survival. The result is that the majority of very small enterprises, new starts, potential entrepreneurs within the community of the unemployed – which were meant to be the focus of the entire BSC network – are increasingly being squeezed out of the client frame as the BSCs go in search of the most lucrative customers. Moreover, as in any organisation undergoing a hasty and unplanned re-structuring exercise, there are also very significant costs and efficiency losses associated with the re-design of the BSCs into straight-forward revenue-generating bodies. Finally, the increased commercialisation of the BSCs will likely have a "crowding out" effect on private sector companies competing in the market to offer consultancy and support services to better established SMEs, larger firms, and the incoming multinationals. This "crowding-out" will naturally cancel out much of the additionality in business support services provision being generated by the BSCs.

5.3.

The all-engrossing search for the most profitable business opportunities means that the BSCs are inevitably neglecting the vital wider externalities and longer run local economic development potentials arising from SME development. Unsurprisingly, the provision of public goods and longer term support measures have little attraction to a BSC which must "earn its keep" in the market-place like any other commercial undertaking. The BSCs services are thus now almost entirely "demand-led", which inevitably means that new SME sectors with high value-added for the local business community, such as innovative and technology-intensive SMEs, will not have a voice *because they do not yet exist*. New SME sectors will therefore find it hard to emerge under such conditions. In addition, strategic interventions at the local level which offer little immediate financial return to the BSC, but which will benefit the local community considerably in the short or long run, are generally eschewed. This was initially the case, for example, with the promotion of industrial subcontracting (Bateman, 1997b), which only became an operational issue when outside funding agencies were belatedly willing to provide financial support.[15]

In addition, policy interventions which have a potential to make a contribution to longer term local economic development are instead often crudely adapted to the need to ensure a BSC's survival, and in the process diluted to the point where they make very little contribution to local economic development. One of the most obvious examples of this development relates to the Business Incubator concept, which is an institutional vehicle which could have had a very useful local role in developing technology-intensive SMEs, commercialising defence industry technologies and promoting the innovation process. And, indeed, Business Incubators proved to be extremely popular with all BSCs, as well as with the international assistance agencies, which have generally provided the bulk of the funds to construct them. However, this interest on the part of the BSC was mainly because the Incubator offered the possibility to generate an income stream which can underpin the BSCs shaky revenue base. For example, the author visited eight Business Incubators attached to BSCs in Hungary, the Czech Republic and Slovenia between April 1996 and December 1998, and all were effectively operating as income generating projects for the BSC concerned. There was, for example, very little serious screening of clients wishing to establish in the incubator, and so clients using the Incubator included vegetable wholesalers, a wide variety of retailers, larger companies establishing a branch office, and companies taking advantage of cheaper rents to store a variety of goods. In the main very little technical support seemed to be available to clients. Other major Business Incubator programmes include the USAID-funded Business Incubators operating in Russia and the Former Soviet Union. The feeling here, too, is that they are only able to demonstrate their contribution to local economic development, and thereby justify their significant international funding, in terms of having simply "survived so far" (see, for example, Schmertz, 1999). Overall, this narrow, short-term focus of the BSCs is especially ironic in view of the fact that a major criticism of the Communist planners was that they failed to understand the inter-connections, subtleties and nuances of longer run, sustainable economic development strategies.

5.4.

There has been a significant opportunity cost to the current BSC network structure in the shape of the "dumbing down" of local government. It is quite clear in most transition economies that local government economic development capacity has effectively been by-passed by the international funding agencies, in favour of the independent BSCs. This has resulted in the traditional economic departments located within most local governments effectively being allowed to atrophy. In a new situation of transition from communism to capitalism, an old problem of "private affluence and public squalor" remains (Galbraith, 1958). Economic development staff in local government have become used to working under severely restricted conditions, whilst attempting to maintain their relationship with their local, and financially well-endowed, BSC. Given that individual local government staff generally have very poor remuneration and working conditions compared to BSC staff, it is not surprising that maintaining this relationship has not always been easy.[16] In Bulgaria, BSC staff generally view local government economic development officials as uninterested in the SME development activities of the local BSC, and only keen to work with the BSC because it is one of the few outlets to hard-currency and foreign travel possibilities (interviews with BSC staff, September 1998). On the other hand, this perception does not stop many BSCs from using precisely their access to hard currency and foreign travel as a "patronage pot" from which they can maintain a coalition of support for their own independence and generous (internationally financed) remuneration. Some local governments have been agreeable to contracting out to the BSCs for the generation of a local SME policy, such as in Vilnius in Lithuania, which makes local government dependent upon both the BSC's operational and implementation services *and* its strategic inputs (interview, Vilnius BSC, June 1998).

This de-legitimising and de-activating of local government economic development responsibility is likely to be a major problem in future. At a time when many western economies are extensively decentralising power and economic development responsibility to regional and local tiers of administration (Rhodes, 1995), and when beleaguered central governments in Central and Eastern Europe are foisting on to lower levels of government more and more economic development responsibility (see, for example, Bird et al., 1995), in Central and Eastern Europe there has been comparatively very little actual SME development capacity-building taking place at sub-national government levels. What is even worse, this omission has taken place even though there was very much evidence to indicate that many local governments under late Communism, and in the early stage of the transition, had acquired some very useful experience in promoting small enterprises (see discussion in Section 6 below). For example, one of the most successful cases of SME support has taken place in Croatia since the late 1980s through the Regional Centre for Entrepreneurship which has operated under the auspices of the Primorska-Goranska regional government. Here, the county government and city of Rijeka have successfully worked together to develop entrepreneurship in the region through patiently building up its own capacity within the Department for Entrepreneurship, promoting Business Incubators which genuinely develop local technology-intensive businesses rather than simply sustain themselves as an institution (see above) and providing a range of affordable financial support programmes for those good business prospects which would nevertheless find it very difficult to obtain support otherwise (interviews, Department of Entrepreneurship, Rijeka, September 1995, May 1997 and December 1998. See also Bateman et al., 1998). Positive experiences such as these could have been an important institutional foundation and source of inspiration for the construction of SME support bodies and local policies indigenous to the transition economies.[17] It also strongly suggests that many local governments could have used a much greater share of the international financial resources devoted to SME development to good effect, or at least no less competently, honestly and efficiently than was expected of the new BSCs at that time.[18]

5.5.

Even when central and local government remain willing to continue to offer financial support to support the BSC networks, it is likely that the real costs of so-doing will increasingly edge up towards the local opportunity cost. The local opportunity cost is represented by the fees paid by the BSCs most financially well-endowed clients, which the outside funding bodies must obviously match if they are to secure its services. It is quite possible that, as demonstrated in the U.K.'s privatisation experience (Ramanadham, 1988), the long term cost of ensuring that the BSCs undertake their originally designated promotional activities will rise at least to the level of the possible in-house equivalent (i.e., where such services are provided through local government offices). They could go higher, too, if the BSCs can protect themselves from competition with other business support services providers through price-fixing, local cartelisation and "gate-keeping" arrangements with some sections of local government (see, for example, Hanson, 1993). Thus, one of the much-mooted advantages of the private sector-led structure for the BSC networks, lower overall running costs for a given quantity and quality of SME development support, looks increasingly unlikely to remain in evidence over the longer run in Central and Eastern Europe.

5.6.

Finally, the stridently commercial culture which has been consistently promoted in the BSC networks has, as elsewhere, undermined any growth of a sense of strategic and longer term responsibility for developing the intended client group. On the contrary, the BSCs' activities increasingly tend to develop on an *ad hoc* basis depending upon the most lucrative sources of funding and short term commercial possibilities. In addition, many BSCs have pushed to fully privatise their activities via an employee or management buy-out. In Slovenia, for example, senior managerial staff in several of BSCs have managed to acquire a personal ownership stake in "their" BSC – up to 40% in some cases – partly, it would seem, in order to ensure that they retain control over "their" BSC and thus their own remuneration and working conditions. However, this has led to serious problems trying to coordinate the strategic direction and operations of the BSC network, and the national SME body – the Small Business Development Centre (SBDC) – has been forced to try to remedy the situation through diluting these share-holdings (interviews, SBDC, Ljubljana, December, 1998). The same privatising trends are evident in Bulgaria, where senior managers have openly expressed their wish to formally buy-out their BSC at the appropriate opportunity (interviews with BSC managers, September 1998). Some BSCs have indicated that they would like to be sold off to a stronger commercial organisation, such as in the Czech Republic, where several of the RAICs attempted to sell themselves as a group to one of the "big-six" consultancy firms (interview, Advisor to Czech SME Agency, May 1998). Even *national* SME agencies are not immune from this privatisation drive: in Macedonia, until recently, senior members of the national agency (NEPA) had been attempting to convert the EU's Phare financed state SME support institution into a private consultancy company in which they would be the principal shareholders (interview, Adviser to NEPA, August 1999). Of course, if such a strongly commercial approach is not precluded by a variety of sanctions and by an appropriate institutional design which precludes "institutional hijacking" (see the very useful discussion in Stiglitz, 1999), and they are anyway effectively encouraged by western advisors and the international agencies,[19] then these are not at all unexpected developments. In fact, it is difficult not to conclude that the BSCs all too often exhibit the same determinedly rent-seeking trajectories as many of the SMEs which they are charged with supporting (see, for example, Hanson's (1993), description of the rent-seeking behaviour of businesses in Russia).

Quite contrary to the largely sanguine official statements about the "good health" of, and the impact made by, the BSC networks in Central and Eastern Europe,[20] on closer examination of their activities it is disappointing to find that they actually look decidedly weak and problematic. If, as seems likely, the majority of BSC networks are eventually fully commercialised and privatised over the next few years, as a response to the international financial assistance drying up and the lack of any offsetting government support or interest, then the loss of both host country and international financial support will be substantial. Apart from the huge financial costs involved in establishing the BSC networks, there is also the tragic loss of time and opportunity involved if the current BSCs no longer do what they were designed to do, and completely new BSCs must now be established from scratch to develop and promote the SME sector.[21] Further, one must also assign a cost to the relative under-development of other private sector business consultancies which were *not* in receipt of the huge subsidy element involved in establishing what has emerged to become a very powerful competitor increasingly seeking out business assignments across the entire range of consultancy contract work. Given these very tangible limitations of the neo-liberal inspired BSC model used throughout Central and Eastern Europe, the question then arises, Was there any alternative to the neo-liberal inspired approach to hand in the early 1990s? And, if there was, Why was it not utilised? We briefly touch upon these important questions in this final section.

6. The "local developmental state" model of SME development

At first sight the experiences of post-World War Two Japan, Germany and Italy, of the East Asian "tiger" economies since the 1960s (especially Taiwan), and of China since 1979, should have been extremely useful to SME policy-makers in Central and Eastern Europe. From this experience emerges a very successful model of SME development which can be termed the "local developmental state" model.[22] This approach reflects the well-known successes of the local and regional level co-ordination and development work undertaken in post-war Japan, the former West Germany and northern Italy (Best, 1990; Cooke and Morgan, 1998; OECD, 1999), but also the more recent successes of Taiwan and China (Lall, 1996; Jefferson and Singh, 1999). The "local developmental state" model also embodies the pro-active local state concept which emerged in the extensive literature on post-Fordism (Piore and Sabel, 1984), as well as the interesting attempts at developing a local socialist economic strategy alternative to the Thatcher administration's top-down neo-liberalism in the U.K. in the 1980s (Campbell, 1990).

Crucially, the "local developmental state" approach emerges from earlier historical episodes which were marked out by a major historical discontinuity, system change, corrupt bureaucracies, huge cultural shift and the need for reconstruction and development from a low base of economic activity. In other words, these historical episodes took place under conditions which very closely reflect the economic, political and social situation in Central and Eastern Europe since 1989. Three similarities are worth exploring a little further, before the model is actually outlined in a little more detail. First, the shift from Fascism to democracy in Italy, Japan and the former West Germany, and from agricultural to industrially-based societies in East Asia, were as much a tectonic change to society and to the business culture as was the shift from communism to capitalism in Central and Eastern Europe. The chaos of post-Communism in Central and Eastern Europe is thus not unique. Moreover, even though the former Fascist states had significant experience with small-scale private business and entrepreneurship, it should not be forgotten that so too had the Central and Eastern European states both prior to, and under, Communism. There was, for example, a large amount of formal business which operated in the interstices of the planned economy and large enterprise sector (Aslund, 1985). Also, widespread toleration of the "second economy" in many Central and Eastern European countries represented a further major concession to small-scale entrepreneurship and to the development of an entrepreneurial mentality (Rostowski, 1989; Brezinski, 1992). The shock associated with the "introduction" of entrepreneurship and private enterprise into Central and Eastern Europe is therefore often over-stated.

Second, there is the question of the corrupt nature of the bureaucracy under Communism and post-Communism in Central and Eastern Europe, which is often said to preclude these countries from attempting to follow in the footsteps of other post-war or post-crisis countries which successfully brought about a state-led transformation and recovery. However, this explanation on its own has limited explanatory power. For a start, no one seriously disputes the fact that many previously Fascist local governments in Japan, Italy and the former West Germany have become extremely efficient local government bodies. Amsden (1989) also notes that the bureaucracy in South Korea was endemically corrupt and weak in the 1950s, but that it was capable of being transformed into an efficient economic development institution by a determined government working alongside an international community which needed the country to become a bulwark against Communism. Essentially the same goes for Taiwan (Wade, 1990). The experience of China since 1980 spectacularly indicates that local government institutions can be radically transformed into very efficient pro-SME bodies given sufficient freedom and resources (Purushotham, 1998). The local state-led new entry programme involving the municipally-owned and established Township and Village Enterprises (TVEs), of which there were nearly 7.6 million industrial TVEs by 1996 (O'Connor, 1998), probably represents the most successful experience of "municipal entrepreneurship" of all time (Jefferson and Singh, 1999; Qian, 1999). Thus, there is no *a priori* reason why the local bureaucracies under post-Communism in Central and Eastern Europe could not also have been similarly transformed into (at least) reasonably efficient economic development bodies. Efficient bureaucratic development institutions, including specifically *local* institutions, have the potential to be developed and replicated in other contexts through adaptation, learning and innovation. As Akyuz et al. (1999) conclude in their study of East Asian development, ". . . recognising institutional diversity should not be confused with the argument that therefore there are no lessons to be learnt (. . .). It is both possible and instructive to identify some major principles that underlie (. . .) successful experience, and to try to adapt the policy tools and institutional vehicles that were used to realise those principles in order to fit local conditions elsewhere, and if necessary devise new policy tools and institutions. Indeed, if East Asian governments had themselves believed in the impossibility of such institutional adaptation and innovation and had ignored earlier success stories, it is doubtful whether we would have an East Asian Miracle to discuss" (p. 33).

Third, excepting the Chinese example, the extent of economic collapse in these previous historical episodes was as bad as that experienced in Central and Eastern Europe since 1989. Post-war Japan, the former West Germany and Italy were all devastated after 1945, while the East Asian economies were also severely handicapped by the legacy of colonialism, civil war and economic destruction. However, the crucial factor in their development was the willingness to co-ordinate and appropriate the available resources (domestic and international) which could then be brought to bear upon the need to guide and finance the reconstruction process, including the support of key SME sectors and related SME support institutions. This co-ordination might well have been possible in Central and Eastern Europe after 1989, were it not for the enormity of the internationally enforced cataclysmic break with, and de-legitimisation of, all previous institutions, agencies and incipient reform trajectories (see Stiglitz, 1999). Thus, there is little strength to the argument that the economic situation in Central and Eastern Europe after 1989 inevitably meant a shortage of resources to build institutions focused upon long term development and comprehensive support for the SME sector: what was missing was actually the willingness or permission (from the international assistance agencies and from their own government) for those charged with economic development under post-Communism to co-ordinate, plan and finance a major programme of SME support (see also the arguments made by Amsden et al. (1994) with regard to the re-structuring of the large enterprise sector).

If we now return to the concept of the "local developmental state" model of SME development, it essentially revolves around the institution-building activities, support, financing and cajoling of local government. Local governments first established, operated and financed a wide range of local state-led and para-statal SME support institutions, which were charged with developing the SME sector over the longer run and in line with local comparative advantages and national priority investment areas. Sometimes this activity was undertaken with the support of central government and national level Ministries, as very much so in

Japan (Glasmeier and Sugiura, 1991), but in other cases simply using the additional financial resources generated by local enterprise development and collected locally via an extensively decentralised taxation system, such as in China (see Oi, 1992; Nee and Su, 1998: Quian, 1999).

Mobilising the agricultural sector was one of the first, and most important, tactics taken by local governments to increase the amount of SME activity. This was done by encouraging those in the agricultural sector to move into small-scale industrial activities. This goal was achieved through offering a number of "pull" factors which ensured that there was a much wider range of freedoms to both generate agricultural profits, and then to relatively effortlessly reinvest them in small-scale industrial activities. For example, the agricultural sector in northern Italy was well-placed after 1945 to move into small-scale industrial activities, having both a long tradition of relative independence thanks to share-cropping and the widespread support of the many new local financial and other institutions established by the far-sighted local and regional authorities (Weiss, 1988; Best, 1990; Schmitz and Musyck, 1994). A key aspect of Taiwan's early reform was the "land to the tiller" programme whereby the government bought land from large land-holders in return for privatisation certificates in the four major state-owned companies, and then distributed this land to the wider population. This raft of new land-holders were then successfully encouraged to work their newly-acquired land profitably, begin the process of capital accumulation, and then make a quite rapid move into small-scale business activities (Chiang, 1999). In China the "house-hold responsibility system" performed much the same task (Quian and Roland, 1994).

Local governments were also quick to realise that affordable finance was a desperately required item, so most prioritised the need to establish strong local and regional state-owned banks and SME funding bodies. This took place in northern Italy (see, for example, Weiss, 1988; Peluffo and Giacche, 1997), in Germany (Heidenreich and Krauss, 1998) and in Japan (Friedman, 1988; Whittaker, 1997). No less successfully, Taiwan developed a dual financial market involving a formal market which dealt with larger enterprises and SMEs, and a centrally and locally well-regulated and monitored informal/curb market providing large sums of capital to micro- and small enterprises (Biggs, 1991). The Taiwanese government is particularly noteworthy for the very significant amount of state resources it has channelled towards technology-intensive SMEs (Lall, 1996). China successfully relied on large state industrial development funds at both central and local level to support SME development (Ze-Wen, 1991), as well as the profits arising from municipal ownership of the TVEs.

A key feature of the "local developmental state" model was the emphasis upon promoting vertical and horizontal networks of SMEs. Many local governments, and their associated institutions, established quite comprehensive policies of linking the local SME sector into larger companies operating locally (for Italy, see Pyke et al., 1990; Japan, see Kitayama, 1995: Taiwan, see Lall, 1996; China, see Zhang and Thoburn, 1998; and East Asia in general, see Meyanathan, 1994). Some local governments became very much involved in sponsoring new entry themselves, in order to develop horizontally- and vertically-linked local production systems, such as in China involving the municipally-sponsored Township and Village Enterprises (TVEs) which constituted the bulk of small-scale industrial new entry activity in the 1980s and 1990s. In all these examples, comprehensive local SME development was underpinned by local and regional government's strategic planning function, a feature which allowed for the co-ordination of scarce reconstruction and development resources, and subsequently the exploitation of local and regional comparative advantages by key SME sectors.

Finally, in all the successful examples of post-war and post-crisis reconstruction and development where SMEs played a major role, there was a critically important element of equity and fairness in the local economic development work promoted and regulated by local governments. This resulted in the construction of a social consensus which accepted the apportionment of the risks and rewards of the chosen development trajectory. Essentially, this social consensus acted to embed the development process within the community as a whole ("reconstruction and development which benefits everyone"), as opposed to it being largely the preserve of the more aggressive or well-connected sections of the community ("reconstruction and development which benefits an elite"). Social welfare spending was maintained as a priority. In some cases, the local labour force was also willing to accept flexible employment practices, in return for a fair disbursement of the costs and benefits of local economic success being distributed through comprehensive social programmes, such as the establishment of pre-school education programmes, health centres, unemployment payments, and the like (Trigilia, 1990; Watkins, 1998). In addition, by engendering trust and encouraging many varied forms of social engagement in the locality, greater equality and community involvement had the effect of underpinning the key institutional foundations of civic society, which in turn is increasingly seen as pivotal factor in creating the most propitious local environment for economic development (see North, 1990; Putnam, 1993).

Overall, these earlier historical episodes of post-war and post-crisis reconstruction and development demonstrate that an immediate, continuous, equitable, and wide-ranging contribution to reconstruction and SME development was possible through what has been termed the "local developmental state" approach. Notwithstanding this very positive experience, the "local developmental state" approach has played a comparatively minor role in informing Central and Eastern European governments of the enormous potential of the SME policy interventions on offer. Several reasons account for this omission. First, as I have outlined, the economic development success in these earlier historical examples was achieved very much because of a significant degree of state intervention and capacity-building (albeit at the local level), and it was this level of state intervention which was anathema to the range of neo-liberal proponents and institutions working in Central and Eastern Europe in the 1980s and early 1990s. Resistance to any form of state intervention was deeply ingrained in many of the government assistance departments, consultancies and major international assistance agencies which were called in to assist with the transition. Many of the most respected international establishments and individuals steadfastly refused to accept the very positive role of the state in several of the most important post war and post crisis reconstruction and development episodes. Until relatively late on in the 1990s the World Bank also remained unconvinced of the possible positive development impact of the state, both central and local (Amsden, 1994), and this overall reticence quite clearly affected its operations within Central and Eastern Europe in the early 1990s. Essentially, state intervention was very successfully portrayed as a return to communism.

Second, irrespective of accepting any direct role for the state, many of the fundamental principles of the "local developmental state" approach were also anathema to the neo-liberal agenda: in particular, the idea of the state allocating subsidised financial support to what were seen as the best long term SME prospects taking into account a number of wider factors (e.g., generating externality economies, strengthening supply chains, positive social welfare implications, import substitution, export promotion).[23] Forms of capital allocation other than on the basis of the prevailing market price of capital have been determinedly resisted by the international financial assistance agencies from the 1970s onwards, as the neo-liberal agenda has been successful in shaping the standard development methodology, particularly in LDCs (see, for example, Buttari, 1995). Instead, neo-liberals value the simple textbook argument which holds that financial resources should be allocated on strict market criteria alone, otherwise scarce financial resources are by definition being allocated sub-optimally: that is, towards those enterprises that cannot afford the *current* market price of capital, and away from those that can.

Third, facilitating social inclusion, promoting equitable development, offering strong support for the education system, and valuing fairness, were all vitally important factors underpinning successful economic development in the previous historical episodes described. Yet, given the imperatives of neo-liberalism, the idea of promoting such concepts in the transition economies of Central and Eastern Europe was quite unrealistic. For a start, World Bank and IMF support programmes (Structural Adjustment Programmes) have overwhelmingly been conditional upon cuts in the real financial and social wage in order to reduce consumption, discourage imports and improve the macro-economic situation. Moreover, the neo-liberal discourse actually sees development as a function of an *increased* level of inequality: for example, generally lowering the fiscal burden on the state, enterprises and entrepreneurs, which also reduces resources available for redistribution; dismantling the previously generous and equal access social welfare and education systems; allowing for low wage rates and minimal encouragement for trade unionisation, which increases enterprise competitiveness in the short term and attracts mobile multinational capital flows; privatisation of public services in general, which leads to the allocation of services according to the ability to pay rather than need or social benefit; and, privatisation of the industrial sector (either through vouchers or direct sale) which facilitates the accretion of capital into the hands of a small elite. It is not surprising, therefore, that inequality has increased dramatically in Central and Eastern Europe (Milanovic, 1998): it is also perhaps not surprising that economic development, too, has failed to take off in the manner expected at the start of the transition.

Fourth, the development of inter-enterprise linkages, effective sub-contracting and horizontal networking require a deeper business understanding and acceptance of co-operation, social interaction and the need to develop relationships based on trust (North, 1990; Pyke, 1992, 1994). However, the emergence of these concepts has been greatly undermined by the highly individualistic, "macho management" philosophy promoted by, and inherent to, the neo-liberal discourse (see, for example, Sennett, 1998). One result was that, after many years of being cosseted by the state, enterprises were bullishly encouraged to "stand on their own two feet" and not seek outside help (i.e., from the state, other enterprises). Entrepreneurs making it into government and politics also often promoted the idea that SMEs "could do it on their own" and thus would not require extensive government support programmes.

Fifth, it is often overlooked that a modest range of institutions and initiatives dedicated to SME development became established within the orbit of the local state under late Communism. Moreover, many of these had begun to attain a reasonable level of efficiency, particularly in the former Yugoslavia, Hungary and Poland (see World Bank, 1981; McIntyre, 1988; Petrin et al., 1988; PPI, 1993; Bateman, 1993; Coulson, 1995). For example, by the 1970s Yugoslavia had evolved a quite advanced local support system for small enterprises, mainly in order to absorb the huge flow of remittances from Yugoslav guest workers employed in Western Europe (World Bank, 1981). In Bulgaria, one of the most Stalinist of the Eastern European communist states, some local state administrations and quasi-independent industrial development bodies, such as the Bulgarian Industrial Association, were able to get very actively involved in promoting SMEs (albeit, overwhelmingly in state ownership) starting as far back as the early 1980s. Using local funds and funding from a specialised bank – Mineral Bank (Bank for Economic Initiatives)[24] – a number of technology transfer projects (particularly where this involved electronics) and business innovation centres were established, and over 400 technology-intensive SMEs were created (McIntyre, 1988). Even in the former Soviet Union, where some local state officials remained very much *against* the idea of the private sector when it emerged in the shape of the so-called "co-operatives" promoted under Gorbachev (Jones and Moskoff, 1991), there were nevertheless many examples of pioneering regional (*oblast*) and local government administrations working against the odds to develop new small-scale private and state-owned enterprises, particularly in the science and technology field and related to the military-industrial complex (OECD, 1994). Yet these modest local state-led institutional support structures which emerged under late Communism were deliberately swept away in the first flush of reform after 1989 (and in the former Soviet Union, after 1991) because they did not accord with the simplistic models of local enterprise development and support favoured by neo-liberals. As Stiglitz caustically notes (1999, p. 22), the international assistance agencies and their advisors, ". . . seem to have seen themselves on a mission to level the "evil" institutions of communism and to socially engineer in their place (using the right textbooks this time) the new, clean, and pure "textbook institutions" of a private property market".

Of course, it should be recognised that many of the first wave of officials and advisors coming to Central and Eastern Europe were quite unfamiliar with the region, and were very often *genuinely* surprised to find anything of a positive nature was left after the ravages of Communism and central planning. Many were largely unaware of the extent of the emerging (bottom-up) SME development institutions and initiatives established by the local state under late Communism. When they *were* made aware of the local state's institutions and initiatives, however, they nevertheless remained under strong pressure from above to avoid any attempt to improve and upgrade their performance.

7. Conclusion

The neo-liberal SME policy discourse was heavily promoted at the start of the transition by the major western governments and by the international assistance agencies, as well as by the many advisors and consultancy groups attached to both. Despite the fact that it largely pertained to the very specific ideological, economic and political conditions of the western developed economies, and that it paid little heed to the very relevant experiences of those post-war and post-crisis economies which achieved great success through the "local developmental state" model, the neo-liberal agenda was nevertheless willingly taken on board as "best practice" by nearly all Central and Eastern European governments.

However, this article has argued that the neo-liberal discourse has so far provided a largely deleterious framework within which to provide genuine and longer term support for SME development in the transition economies. The particular example of neo-liberal failure outlined here relates to the BSCs established in all the Central and Eastern European economies after the collapse of communism. The neo-liberal approach adopted by the bulk of SME policy-advisors and host country policy-makers has led to the establishment of BSC networks which can be typified as weak, poorly-functioning, excessively-commercial, determinedly short-termist, and financially unsustainable. Meanwhile, the channelling of international financial support overwhelmingly into the independent BSC networks has left local governments universally ill-equipped to confront the enormous challenges which face their deteriorating communities, and they certainly cannot adequately discharge the increased economic development responsibilities which have been foisted upon them by central government of late.

In the light of the above adverse experience with the BSCs over the last four to eight years, and with a fuller recognition of the success achieved by the "local developmental state" approach, the role of the local state in SME development in Central and Eastern Europe clearly and urgently needs to be re-assessed. Ideological objections to the local state assuming a more strategic and developmental role must be quickly cast aside. There is a pressing need not so much to reduce the size of the local state, which some international assistance agencies and western governments continue to see as a fundamental aim (see, for example, Rama, 1999; plus the papers in the same special edition), but to improve its competence and adjust its modality of operations away from administrative controls and interventions which were meant to *replace* the market, and towards forms of constructive and transparent interventions which *support* the operations of the market and the SME sector.[25] Previous post conflict and post crisis historical episodes indicate that major success was forthcoming because the local state was both powerful enough *and* had the willingness to engage in a pro-active and long term risk-bearing approach to SME development. We would therefore argue that it is in building up the institutions, agencies, financial bodies and regulatory functions which make up the "local developmental state" where a more determined and longer run engine for SME development is more likely to be found in Central and Eastern Europe, and where future SME policy interventions, financial support and technical assistance urgently need to be re-directed.

Notes

* This article was written in a personal capacity.

[1] The material upon which this article is based was collected through a wide variety of field visits and consultancy assignments to Central and Eastern Europe from around mid-1993 to December 1998. Crucially, this included 35 extended interviews undertaken between January 1995 and December 1998 with staff and external advisors working with Business Support Centres (BSCs). Further extremely useful insights were also garnered via participation as a consultant engaged on a number of SME policy review and evaluation assignments for several of the major international assistance agencies, particularly for the European Commission for most

of 1998. Naturally, the views contained herein are those of the author alone, and do not represent any of the organisations with which the author has been, or is currently, associated with.

[2] One early possibility promoted throughout the 1980s by opposition groups in both Poland (articulated by *Solidarity* for much of the 1980s) and in Hungary, was to move towards an improved variant of Yugoslav-style de-centralised market socialism and workers self-management (see, for example, Nove, 1983, pp. 118–153). However, this trajectory was swiftly brought to a halt when the major western governments and international assistance agencies arrived to help with the dismantling of Communism. A possibly more realistic proposition at the end of the 1980s was East Asian-style "guided" intervention, but this too was quickly removed from the policy agenda at the start of the 1990s by the World Bank and U.S. government (Wade, 1996).

[3] These concepts are discussed in more detail in Bateman, forthcoming.

[4] It should also be noted that a good many of these new SMEs were so-called "by-pass firms" – that is, firms which were deliberately established to illegally divert contracts away from larger state firms and into the hands of private firms owned by the state firm's senior management (Prasnikar, 1998).

[5] To illustrate, consider Hungary in a little more detail. A large number of registered businesses are non-operational; most surveys in Hungary putting the figure at between 40% to 50% of the total of registered small enterprises (HFEP, 1996). Most businesses are sole proprietorships; only 28% of active businesses in 1996 had one or more employees (Futo, 1997). Many businesses are simply "second jobs"; just over 45% of sole proprietors in 1995 were undertaking business alongside a full time position or as a pensioner (HFEP, 1996). Finally, many small businesses are actually tax avoidance measures taken by individuals with the connivance of the larger firms which now "subcontract" to them (Futo, 1997).

[6] For example, the historian Garton-Ash (1999) vividly and painfully documents the situation in Gdansk in Poland, the birthplace of the Solidarity trade union. He shows how many of the former shipyard workers and Solidarity activists who established their own small private enterprises after the decline of the Gdansk shipyards now steadfastly refuse to allow their own employees to join existing, or establish their own, trade unions. Working conditions in these new non-unionised SMEs are generally very poor indeed, so much so that more and more employees are becoming increasingly nostalgic about the old system's economic benefits.

[7] Briefly, "crowding out" refers to the knock-on effect of the high profits being realised in some sectors after the instant and uncontrolled liberalisation of trade and business in Central and Eastern Europe after 1989 (in the former Soviet Union, after 1991). The newly emerging private sector financial institutions naturally wanted to appropriate a part of the high profits being generated under the disequilibria conditions associated with the transition, and so the price of capital was increased as much as possible to reflect its local opportunity cost, represented by the very high margins made by traders and importers. Formally, this was very simply achieved by charging high real interest rates. Informally, it was also possible to further push up the cost of capital through the routine imposition of a variety of charges, on-costs and management fees. The higher cost of capital naturally meant that initially low-profit, technology-intensive, innovative and generally high risk SMEs were "crowded out" of the market for financial support (see Bateman, 1999).

[8] The name of these support institutions differs between country – local enterprise agency, regional business advisory and support centre, SME Development Agency (SMEDA), etc. – but they are essentially the same thing.

[9] In Scotland LECs (Local Enterprise Companies).

[10] The model was given great additional political stimulus at the time because it was seen as being able to stimulate petty entrepreneurship within the then very large community of unemployed, whilst simultaneously marginalising Labour party controlled local authorities ideologically hostile to the Thatcher central government and its neo-liberal political programme (Thomas, 1988).

[11] Many of the consultancy companies active in Central and Eastern Europe after 1989 were U.K.-based and had gained substantial experience in implementing and evaluating TEC/LEA projects in the U.K. in the 1980s. Their widespread support for this model is therefore quite understandable from a purely commercial point of view (see, for example, Hindle).

[12] For example, Leszek Balcerowicz, the architect of "shock therapy" in Poland and still a major political player in the country, has always made it clear that he favours offering little state financial support for SME development. He believes that stabilisation, privatisation and liberalisation are essentially all that are required for effective SME development (Balcerowicz, 1995, p. 246).

[13] It should also be noted that up to *twelve* international assistance agencies have been working alongside the EU's Phare programme providing financial support to the LEA network since 1990 (HFEP, Annual Report, 1996).

[14] One extreme indication of the lack of solutions on offer was given by a USAID representative who suggested that their small business centres should consider selling UNICEF cards as a way of raising money to keep going (Pressley, 1995, p. 48).

[15] The Hungarian government, for example, has recently begun to channel support to the LEAs to work on subcontracting promotion (Hungarian Foundation for Enterprise Promotion, Annual Report, 1997). In other countries, such as in Slovakia, UNIDO has been called upon to develop its well-regarded programmes of Supplier Partnership Exchanges (SPX).

[16] One extreme example of this "private affluence-public squalor" phenomenon was in Bosnia-Hercegovina. Very high salaries were structured into a UNIDO SME agency project compared to most alternative local government employment possibilities. For example, advisory staff were paid $1,200 monthly and secretarial staff over $800, in a country where the average monthly wage in the public sector at that time was around the $100 mark. It is not surprising that after such remuneration few development workers considered undertaking similar duties for the local government itself after the UNIDO project came to an end (interview, UNIDO office, Sarajevo, September 1999).

[17] In Croatia the successful experience of the Rijeka region

has been very influential in the design of a local state-led, and centrally supported, programme of SME support initiated by the Ministry of Economy. However, for political reasons carried over from the Yugoslav Civil War, Croatia remains unable to tap into international assistance for SME development, particularly from the EU's Phare programme, and so its rather unorthodox local institutional support structure has not come under any external pressure to be amended in favour of the BSC model supported elsewhere in Central and Eastern Europe (briefing material, Ministry of Economy, September 1998).

[18] Much criticism has been levelled at the inefficiency and corrupt proclivities of the personnel in the old communist bureaucracies, but it should be noted that a very great many of them became key figures in the BSC networks.

[19] This was, for example, one of the elements of "good practice" highlighted in the major survey of donor experience summarised by Gibson (1997).

[20] Phare enthusiastically reported that its own BSCs "have been very successful in most countries and, (. . .) have played a positive role in the development of local economies" (Phare 1997b, p. 38).

[21] This is already starting to happen. For example, in Latvia the initially EU-Phare funded BSCs have been cut adrift of government support and support is increasingly being directed to newly-established "field offices" located within the municipalities (interview with the Team Leader, Phare SME Programme, Riga, June 1998).

[22] The term is naturally a reference to the "developmental state" concept introduced by Johnson (1982). The idea is more fully explored in Bateman, forthcoming.

[23] The neo-liberal position, of course, ignores much of the development economics literature which holds that relying on current market prices to guide investment decisions will lead to sub-optimal development in the longer run. For example, Scitovsky, one of the pioneers of growth theory, argued that we should not rely on the current market price of capital to direct investment decisions since it will ". . . reflect the economic situation as it is and not as it will be (instead) investment decisions should be governed . . . by what the future economic situation is expected to be." (1963, pp. 305–306. Quoted in Pack and Westphal, 1986).

[24] It was planned that about 5% of total national capital investment would go through Mineral Bank in this way (McIntyre, 1988, p. 605).

[25] As Killick and Stevens (1992) warned very early on in the transition, this is one of the important lessons to be learned from developing country experience. It was a warning which went largely unheeded.

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