Thesis:
The Rise and Demise of SME Discourse Within
Mainstream Development Theory – History and
Lessons

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The undersigned hereby recommend to
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**The Rise and Demise of SME Discourse Within Mainstream Development Theory – History
and Lessons**

submitted by

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in partial fulfilment of the requirements
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Abstract:

This thesis takes a look at the history of the discourse surrounding Small and Medium Enterprises (SMEs) within development literature. It argues that the discourse around SMEs follows a general line of thought and changes over time as the main discourse within development changes. The thesis traces the beginning of development theory and the intersection between the general discourse and SME discourse in particular. It argues that SMEs were not a matter of concern for early development theorist. However, with the onset of liberal ideology, the World Bank and other economist took an active interest in SMEs. However, the view that SMEs can be independent development mechanism was quickly supplemented with a strong current arguing for a liberal economy. Steps taken to help SMEs became indistinguishable from steps taken to promote the liberal agenda associated with structural adjustment program. The essay takes a look at few case studies and argues that the example that best follows the World Bank's suggestion, such as Lebanon and Egypt tend to produce little in results, while independent programs such as those sponsored by South Korea and Taiwan produce more effective results.

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Introduction

Development discourse encompasses many subtopics such as the environment, gender, economic development and human rights. These subtopics deal with specific issues that are contextual in nature and responsive to an ever-changing environment. However, these discourses are encompassed within a larger vision, a larger macro Discourse. This Discourse molds the sub-discourses and gives them direction. During the 1950s, the macro Discourse and much of the subtopics were centered on modernization theory in general and industrialization in particular. Throughout the late 1960s and early 1970s, the macro discourse changed and became dominated by liberalization theory. This theory promotes free trade, increased economic freedom and less intervention by the state. The main thesis being presented in this paper is that within established development circles, especially the World Bank (WB), the macro discourse takes precedence over the subtopic to such an extent that it renders the flexibility of the micro discourse irrelevant. The paper traces the origin of the Small and Medium Enterprise discourse as an example of macro/micro interaction within development circles to illustrate how the macro discourse engulfs the subtopic to such an extent as to disarm it of its potential.

This paper begins by addressing the change within macro theory from industrialization to liberalization. The aim is to show that the major theories and thrusts of development institutions are self-referential: that is, development speaks to itself and not to its object (the developing world). The developing world is the test ground, the justifier and the scapegoat for development discourse. Development as an enterprise is a euphemism for producing economic zones and practices that are in line with international economic wisdom, reducing the scope and scale of development concerns. The relationship is not necessarily clear or conspirator. It is however, definitive. Development theory and practices follow the dictates of the international economic

system. This paper uses the discourse of Small and Medium Enterprises (SMEs) to illustrate how different patterns of discourse within mainstream development morph from points of challenge that can generate change into a system enhancing activities.

SMEs provide a good study case because of the amount of attention and support they generate from interested parties. SME's, are simply stated, in vogue. They offer an exotic, idyllic vision of capitalism driven by innovation, of entrepreneurship and heroism in a world dominated by conglomerates. Thus the image of SMEs is a powerful economic tool, and how this image is perceived is usually a reflection of what type of economic policy is being implemented. Thus the research studies the WB's association with SMEs in order to see how the Bank strips these institutions of their intrinsic value to build an SME discourse that supports the Bank's aim at liberalization, privatization and globalization, reflecting the dominant interest of the world market. The Bank uses SMEs in different roles in order to achieve one goal: the validation of the Bank's vision of what economic activity should look like. Thus SMEs are brought into focus through their role in poverty reduction and employment generation. They are to be used not to develop viable economic activity, but to reduce government interference and allow the market to govern transactions. The problem with this approach is that it fails to provide SMEs with enough support even to accomplish those two tasks entrusted to them by the Bank. This vision is limited in scope; SMEs do have a role to play in the economies of developing countries, but they need to be treated as viable economic entities that are needed to support industrial activity. However, their survival is depended on interventionist policies that ensure continued financial support and viability.

The essay is divided into 10 sections: the introduction is followed by a brief look into the history of development discourse showing how the discipline changes from industrial emphasis to a liberal emphasis. Following a discussion of the liberal turn, the thesis briefly explains the economic shift from fordism to post-fordism and illustrates its implications. This is followed by a discussion of SME theories and their contribution to economic growth that will be contrasted with the practice of supporting SMEs in institutionalized development circles. The essay then looks at specific case studies to determine if the bank's emphasis on market mechanisms and non-intervention are warranted. The study then looks into the contribution SMEs provide to development discourse and how this potential is thwarted by the dominance of the liberal market economy mentality over developmental goals. It ends with a recapping conclusion.

The methodology of the paper is eclectic. Theories are studied, criticized, but elements from them are retained to offer some sort of advice towards the end.

Development is a struggle, a struggle involving clashing visions and economic systems. This struggle is governed by the overriding rationality of the development enterprise. The struggle takes place within the context of this rationality, either as opposition or support. This rationality is what makes development into a project, an enterprising project. By definition, a project has a function, and a blueprint to achieve this function. However, the development project is not so refined. Its blueprints seem lacking in depth. The specific directives are not laid out beforehand but develop along lines of international economic structures. The players within this project struggle to effect the direction of the plan. The result of their struggle is most forcibly expressed in the economic sphere. However, economics are not the only aspect of development. As a human enterprise, development easily encompasses many aspects of daily existence beyond the restrictive sphere of economics. These aspects of development force

themselves to the forefront through their sheer size and necessity. Poverty, the environment, social justice, women rights, are all issues within development. Their existence forges new pathways within the discipline. The development enterprise is able to accommodate these concerns within the scope of its economic rationality. Some of these concerns become institutionalized. In fact, to a degree, all of the above have been institutionalized. That does not mean that the struggle has abated, or that their inclusion is merely cosmetic. They did expand the debate, however, they have been made subordinate to the general economic concerns, and to a specific thought process regarding this economic concern. Not all of these sub-topics of development are equal. Other than growth, poverty has been the second most insistent theme of development. Poverty is a good theme to take up because it has both economic and social aspects. And it is a widespread phenomena that is, to an extent, the spirit and reason of development. Thus, the way poverty is treated in the development enterprise discourse is illustrative. In essence, the clash within development enterprise has been between the macro and micro aspects of development. To simplify matters, we can juxtapose poverty and growth, illustrated by emphasis on industrialization, as the two major competing themes within development. Their clash, so to speak, has not produced either a clear winner or a synthesis of a sort. Both have been eclipsed by the use of poverty to justify the expansion of international markets into developing countries. The clash between growth and poverty has been sidelined in an interesting fashion. Both concepts have been attacked as non-sufficient to answer the problems of development. As such, the failure of both concepts is seen as an indication that the primary solution, for all development problems, is the market economy. The paper will begin by following the themes of growth and poverty and showing that their clash in early economic thought did not lead to a synthesis, but to the demise of both concerns to the forces of the

international market. This is not a new phenomena, the paper's thesis is precisely that the international market determines and frames the context of the debate. However, the disturbing fact lies that within the new discourse, growth and poverty are both poor cousins to deregulation and liberalization, a development that is less than ideal when dealing with development issues.

The beginning of Development theory:

Development as an enterprise was given hope with the success of the Marshal plan. The success of US aid in re-developing war-ravaged Western Europe was a very attractive option to enticing the support of newly independent countries with socialist inclinations.¹ This political aspect was reinforced by an economic theory that believed in the benefits of bringing these regions fully within the circle of capital accumulation. Economists studied given areas and used the science of economics to begin the work of modern development. The initial comparison was between the developed and the developing worlds. To many, the underdeveloped world was a reflection of "what once was" within much of the Western world. Intellectually, development as a project resembled a personal trip down memory lane. The underdeveloped world, tapping into the hindsight of the developed, could mirror the latter's progress. This hindsight would serve as a propelling force condensing history to produce quick results. Since its earliest beginnings, the history of development was undertaken with adherence to economic laws. Unlike authors such as Polanyi, early development economists understood development as a process occurring within the laws of the economics and not as a process that creates these laws. Ironically, the short history of modern development economics is a process of re-writing laws and acting with mixed regard to the laws of the market.

¹ Kimber Charles Pearce Rostow, Kennedy and The Rhetoric of Foreign Aid USA. Michigan State University Press. 2001. p 18.

Early development economists used economics as a tool to construct a market that would function within the global sphere of production: a market that behaved and produced in a fashion similar, in theory at least, to the one operating within the developed regions. Development had a goal then, and to the disdain of many, the final goal was declared to be mass consumption. Rostow introduced his famous and heavily criticized theory early in the 1950s. He postulated development as a linear process that happened once in England and that would eventually spread across the globe. Most of the underdeveloped world, according to him, was situated in either a traditional stage or a pre-takeoff stage. The natural process of progress, and now the role of development as an enterprise, was to propel these regions into at least the takeoff stage. This stage in turn should allow these countries to sustain increased economic maturity and to eventually reach the stage of mass consumption.²

Rostow's theory can be described as a historically specific inquiry without regard to time. By using early industrial England as a basis for his theory, Rostow universalizes the experience and generalizes that the same path taken by England would and could be mirrored elsewhere in similar fashion. Thus it was historical specificity made universal. The specific problem facing the newly emerging development field was time. The first time-bound problem was that the period to be emulated has already passed by. This is what makes current development "miracles" susceptible to generalities. Since the period Rostow was taking about has already passed by, the first tactical problem of development was to help re-create the conditions in the targeted developing world so as to resemble one stage or another of England's industrialization. Time was in short supply. The newly liberated colonies did not have the luxury of centuries of auto-centric development. The major task of development enterprise was to condense and

²Walt A. Rostow The Stages Of Economic Growth New York. Cambridge University Press. 1968. P 4.

intensify the British experience and propel these nations from their pre-takeoff and even traditional stages to take-off stage. The most efficient route to condense time and propel these nations from pre-take-off to take-off stages was to ensure sustained economic growth. Development must offer the means since pre-take-off societies exist in a less “intense” level of economic activity thereby presenting less opportunity for economic breakthroughs. External interference becomes necessary. Rostow was not the only one to hold such a view. Economic interference in internal situations was not a new thing. A large segment of the world was still colonized. Even the idea of beneficial economic interference was not new. A century earlier, Marx had argued that imperialism would bring with it the seeds of industrial capitalism to the colonized world. His vision was not a rosy one since Marx understood the peculiar nature of industrial capitalism as a force that brings with it change in an unprecedented speed and scale. However, Marx’s writing on Ireland, the only colony he was familiar with, revealed that colonialism does not necessarily usher in capitalism. What Rostow, and other development economists shared with Marx, is a realization that the introduction of capitalism into the developing world will lead to conflicts. Rostow was aware that development by its very nature was displacing; it displaces economies and populations. However, this displacement was a good thing. It was an essential feature that would allow for growth and create the necessary pre-conditions for industrialization. Even in this accelerated environment, take-off stage is not reached automatically. First, the pre-take-off stage must provide a revolution in agriculture, increase transport efficiency and facilitate the establishment of markets and specializations. This stage should also exhibit other characteristics of increased economic activity such as a rise in imports, capital formation, and the establishment of a political elite interested in economic development. The take-off stage itself lasts between 20-30 years. During this stage, net

investment increased from 5% to over 10%. Rostow argued that 10.5% level of investment is needed for an economy to grow by 3% if the population is growing by 1%.³ In addition, manufacturing needs to take hold of at least once sector of the economy. And last but not least, the developing political system must be enthusiastic and ready to exploit emerging opportunities in the modern sectors of the economy. The resulting industrial development should lead to a sustained take-off and culminates in the age of mass consumption.

Rostow is an interesting figure because of the influence and level of support he was able to gather despite the empirical and theoretical flaws in his theory. His theory was hopeful and practical and simple. It offered an approach that was neat enough so as to convincingly represent a fictional history promising an exciting future. Thus the history of England, and in his later writing, Japan, Germany, and Russia, is combined with the present status of the underdeveloped countries to provide the future possibilities of the pre-take-off stage. The destruction of the pre-take-off societies for the sake of development was seen as necessary and good. Rostow, as mentioned, was not the first to accept the pain of development as a necessary feature of the phenomena. This belief was wide spread among Rostow's contemporaries. Most viewed agricultural societies as antithetical to industrialization and growth. These societies were in need of destabilization in order to generate industrial growth. Rostow's contemporaries produced more academically solid analysis for the problems associated with development. Scientific theories were developed. And the acceptability of these theories was itself a sign of development in the emerging field of development economics and of development within the developing countries. Rostow had a major grievance against traditional societies. These societies did not operate on the premises of Newtonian mathematics. What he meant by that is that traditional

³ Walt A. Rostow The Stages Of Economic Growth P 8.

societies were not the masters of their realm. Newtonian mathematics implied that the unknowable external world was indeed knowable and malleable to manipulation.⁴ Rostow did not think most ex-colonies could affect their environments dramatically. This was another reason why development must destroy traditional societies. The degree of Newtonization is an indication of the rationality and cultural adaptability to development. This theme, which verges on racist themes, has a long history in colonialism and continues to be dominating today in development circles. We attend to this topic later on in the thesis. Thinkers before and after Rostow pointed to the problems associated with unscientific management of resources as a major obstacle to development. The answer to this problem, in early development writing, was industrialization. This, in turn, was dependent on the destabilization of the existing social order. The hope of and for scientific development did not stem from an ill-conceived historical look at England, but stemmed from a deep belief in the desirability and success of scientific methodology in achieving optimal results. Development was now to be determined by formulae and equations: “it is this ordering of economic progress by means of formulae, equations and interlocking of planning measures that is typical of the mid-twentieth-century attack upon the problem of underdevelopment.”⁵ This quote from the mid-sixties is perhaps still an accurate description of development as a project. The method promising the greatest success of scientific management was industrialization. As a system, industrialization was important not only because of its cross sectoral integration, but also because of its ability to systematically order production. Simon Kuznets, an important development theorist, echoed these notions of science, industrialization and development: “indeed, modern economic growth is, in substance, an application of the industrial system, i.e., a system of production based on increasing use of

⁴ Walt W Rostow. The stages of economic growth p 4.

modern scientific knowledge.”⁶ The unification of industrialization and scientific knowledge offers a good insight into the meaning and affect of industrialization.

Development as it was understood then focused largely on theories of scientific pretence. It was seen as a problem of time incompatibility. The developed and developing world existed in two different time frames, the role of development was to narrow the gap. This was to be done scientifically and efficiently. Through encouraging growth by industrialization, Newtonian thinking would seep in to the developing world and cause the much-awaited transformation to something more hospitable to development. Science and industry are linked to growth. Kuznets captures the relationship between science, industry and growth by stating that modern growth has “two distinct features: in all cases, it involves a sustained and substantial rise in product per capita and in almost all cases, it involves a rise in population.”⁷ Modern economic history is linked to the phenomena of modernity: the growth of scientific thinking, humanistic emphasis, and modern day capitalism. Perhaps the most powerful locomotive in this triad is capitalism. Another significant feature of modern growth is population growth. In fact, the two are linked together. Theories abound regarding the relationship between modern growth and population growth. Some contend that capitalism was able to allow for a vast expansion of population and others contend that population growth itself facilitated the growth of capitalism. In either case, population growth, capitalism, and modern growth seem to form a self-propelling triad. In development literature, the relationship of population and growth is not as straight forward. The triad does not seem to move in unison. However, in the early part of the 50s, population was still

⁵ Alan B Mountjoy Industrialization and Developed Countries London. Hutchinson & Co Ltd. 1966. p 80.

⁶ Simon Kuznets Six Lectures on Economic Growth New York. The Free Press. 4th printing. 1968. p 15.

⁷ Ibid. P 14.

seen as an essential element in the growth equation. Rostow reminds us that growth in agriculture in England allowed for a population and labour growth. This abundance of free labour formed the first locomotive of early capitalist enterprises. Labour productivity is essential in generating growth. The relationship between agriculture, labour and growth was made more explicit with the theories of W. Arthur Lewis. He formulated what has been termed the dual economy theory. Roughly stated, this theory postulated the existence of two sectors within developing countries economies: a productive and non-productive sector. Lewis was concerned that the agricultural sector in developing could impede industrialization because it could create a labour shortage. Lewis assumes that agricultural production creates zero productivity. Industry needs labour, and in most developing countries, most of the labour force is engaged in agriculture. For the industrial sector to be able to attract labour, it must provide subsistence level income in addition to an incentive compensating the laborer for the hardships involved in dislocation. With such an incentive, the employer will be able to attract unlimited supply of labour. The capitalist will hire enough labour until their extra output equals the cost of the wages. Additional productivity emanating from labour will be translated into surplus, which consists of the amount between wages and marginal productivity. This supply, when reinvested, increases the amount of capital per worker with increasing marginal productivity. This cycle continues until the surplus labour is absorbed. Beyond this point, labour can be only attracted by additional wage increases. In Lewis' model, labour creates capital. It accomplishes that by being drawn from the negative, or marginal agricultural sector towards the productive industrial sector.⁸ He acknowledges that this model suffers from some problems; the most internal of these problems is surplus labour. Why and how can industry attract surplus labour? Lewis' answer

⁸ E. Wayne Nafziger The Economics of Developing countries New Jersey. Prentice-Hall, Inc. 1997. p 101.

was that additional financing, maybe from outside, would be required to initiate this transfer. This is problematic because it, in reality, breaks away from the model and it re-qualifies finance as the true productive capital and labour as marginal capital. His theory is based on the internal dynamics of an economy and how its contradictions can bring about structural change. If the structural change is imported, then the economy never achieves a healthy equilibrium. In fact, the differentiation and separation between the two sectors would be more pronounced.

What is interesting in Lewis' model was his structural approach. The intent of the theory was to produce value out of the contradictions that can be found within an economy. This approach is novel, the methods and details and measurements of value are more problematic. His model had common features with many policies being used and contemplated around the world. Agricultural reform has been recognized by many as one of the most necessary preconditions for industrial growth. By the time Lewis' was writing, full-fledged agricultural trials were continuing to take place in the Soviet Union, and much of the third world, with varying degrees of success. What was harmful in Lewis' theory, much more harmful than the wage predicament, is his value calculation for agriculture. This theory, which verges on disdain for agriculture, reflects ignorance of land issues and the social, political and economic implications associated with land reform. This failing is perhaps a reflection of the single-minded emphasis on the market mechanism within modern economic discipline and the theoretical separation of social and political institutions from economic ones. He fails to see agriculture as an integral part of the makeup of most developing countries, in fact, of all countries in the world. His theory does not give enough attention to the nature of agriculture and fails to recognize that its role can expand beyond theories of marginal productivity and competition with industry over labour. Lewis viewed development as a set of factors that can be

manipulated by addition and subtraction to create growth. In short, the thought process governing thinking about industrialization was industrial in its essence. Lewis, and later, Domar, Harrod, and to some extent Solow, Hirshman, and Nurske, viewed growth as depending on factors of production. The more factors you include in the equation, the greater the growth. Their theories differed and were not as simplistic as this brief introduction suggests, however, growth was seen as being a result of inputs being accounted for in order to generate a mathematically observable output.

This growth model emphasizing inputs and outputs was not unique to Lewis. Other theories designed for industrial nations and emphasizing capital accumulation and generation were soon applied to developing nations. The Harrod-Domar model was initially designed for industrial countries but was used to estimate capital requirements for developing nations.⁹ This model focuses on investment and income as variables. The theory stipulates the existence of a correct level of investment and savings. In order to muster required capital, planned savings must equal planned investment. If then the actual growth rate does not equal the warranted growth rate, then the economy could suffer serious variations expressed as either being too much growth with hyperinflation, or stagnation.¹⁰ The model suffers from a number of shortfalls. First, it assumes that all savings are turned back into investment and it also assumes that the savings being reinvested will be directed to where the markets need them most. This model, despite its mathematical rigor, can be used to describe why the economies of developing nations fluctuate but is not an adequate development guide. Other less mathematical models were presented as possible guides for developmental strategies. These models derive their legitimacy

⁹ Gerald M. Meier The Old Generation of Development Economist and The New in Gerald M. Meier and Joseph E. Stiglitz. "Frontiers of Development Economics". New York. Oxford University Press. 2001. p 14.

¹⁰ E. Wayne Nafziger The Economics of Developing countries P 123-124.

from the displacing effect of development. In line with Rostow's and Lewis' insistence on destroying the old and creating the new, and on their belief in the "goodness" of societal turmoil, most of these theories emphasized that development is achieved through exaggerating one or more elements of the unbalance to create growth. The first theory to be briefly outlined here emphasizes the possibility of auto-centric development by using the contradictions found within developing nations to propel them towards growth. Hirshman, the major proponent of this idea, advocated the use of unbalanced investment strategies.

In Stages of Economic Development, Hirshman states that development depends "not so much on finding optimal combinations for given resources and factors of production as on calling forth and enlisting for development purposes resources and abilities that are hidden, scattered, or badly utilized."¹¹ He argues that the best method for rapid growth is to plan an unbalancing act in the economy. Development strategy must spur on further investment. He argues that neither savings nor entrepreneurship is in short supply within the developing world. Simply stated, their combined effect is negligible in generating the economic change that is desired by and for development. Thus, an investment strategy is needed. Investment should occur in the industries that would create the greatest backward and forward linkages within the economy. Hirshman's model is admirable for its insightful look on the role of auto-centric development, the need for an investment strategy, and the importance of creating self-sustaining circles of accumulation. However, it suffers from the same factor that haunted Rostow and is the scourge of development even today: time. Like all anxious development strategies, time is seen as a major variable that must be combated and incorporated. Time in development has an extreme importance. It is a problem that must be surmounted. Time is always in short supply;

¹¹ Albert O. Hirschman The Strategy of Economic development USA. Yale University Press, Inc. 1958. p 5.

developing nations exist in a different age so to speak. The role of development, as has been mentioned, is to modernize these backward regions. Time is also a constant reminder for development economists and officials in the field. The antiquated agricultural techniques and superstitious beliefs haunt foreigners and locals alike. These practices must be combated and destroyed in order to generate “Newtonian thinking”. Time has another usage in development as well. Time is an essential ingredient for proper development. It must be compressed but not rushed. Time created by the market is good time; time created by society is an inefficient time. It is often heard that countries need time to develop; yet many development institutions are quick to condemn any development experience that does not create a “good” time. Labour time is not good time, market, or flexible time is good time. Hirshman was not immune to this time phenomena. He had to face the time factor in all of its facets. Agriculture, and the time frame it exists in is bad time. The market that exists within these societies is different then the market that exists in modern societies and thus is bad time as well. For Hirshman’s model to work, a plan promoting industrialization needs to be in place. This plan is unlikely to be generated solely by the existing market or the government on its own. A joint venture must be undertaken to spur on investment. With limited resources, developing countries can ill afford to squander their resources on several areas all at once. Thus these countries must deflect investment from certain areas of the economy and re-direct it towards needed industry. Hirshman’s theory emphasizes the role of investment even more than the Harrod-Domar model. The theory ignores agriculture and views it as something that competes with industry for resources and as something that produces food. Thus it ignores the social aspects of agriculture, such as tradition, land ownership and security. Perhaps Hirshman can be excused. Development was, and still is, an image. But unlike the 30 something wielding a cell phone in a remote region, development back then meant

a factory, a big factory, with sweaty men and smoke. It did not mean families toiling the fields. The summoning of nature that Hirschman calls for in his earlier quote had a far greater appeal than the image of tackling gender, equality and human rights issues associated with the process of development. Agriculture was to be ignored so that industry can rise.

Others argued that a single focus theory was not a practical solution for developing nations. Ragnar Nurkse proposed a synchronized application of policies across the board as the most effective way of promoting investment instead of tilting the economy:

The difficulty caused by the small size of the market relates to individual investment incentives in any single line of production taken by itself. At least in principle, the difficulty vanishes in the case of more or less synchronized application of capital to a wide range of different industries.¹²

Nurkse attempts to get beyond the single-mindedness exhibited by the Hirschman approach. His model aims to move the economy in unison instead of moving one piece and hoping that the economy would be forced to follow. The argument simply runs as follows, since we cannot make sure which sector of the economy to invest in the most, then we have to invest in multiple sectors at once since no single sector can be guaranteed to move the economy forward. The most immediate criticism of this theory stems from its lack of efficiency. Precious capital can be much more effective if concentrated instead of being spread across the board thinly. This spreading of resources is seen as something beyond the means of most developing nations. Thus a more concentrated approach is needed. The Hirschman model agrees more with comparative advantage than does the Nurkse model. Hirschman's theory lends itself easily to specialization, while Nurkse focuses more on approaching development as multifaceted phenomena.

¹² Ragnar Nurkse Problems of Capital Formation in Underdeveloped Countries Oxford. Basil Blackwell. 1966. p 11.

In all of these models, the aim was to increase the growth rate via increases in industrialization. Growth was seen as the most important problem facing the developing world. Through growth, other problems associated not only with the economy, but also with the general make up of the developing countries, can be addressed as well. Through industrialization, modern elements can be introduced into these societies. The temporary dislocating affect of competing social production processes would eventually be solved when “Newtonian” thinking banishes traditional forms of socialization. Most authors briefly sketched above had an inherent bias against agriculture. Thus another positive feature of industrialization was that it would diminish the role of agriculture in the economy. The strongest biases against agriculture were displayed by Rostow and Lewis. This current recedes in intensity as we move further along, especially with the writings of Nurkse. These developmental visions were grandiose and geared towards increasing the stock of capital within developing countries. This emphasis remains strong today as well but to a lesser extent. The most effective method of generating growth was agreed to be increasing the levels of industrial investment. Hirschman, the proponent of unbalanced growth, is a strong supporter of the industrial emphasis. Creation of the market was a secondary goal for him. The first goal should be the promotion of industry:

It has been convincingly shown that entrepreneurial ability as such is not usually lacking in underdeveloped countries but that because of foreshortened time-horizon and insufficient knowledge and experience, it is often deflected from the promotion of industry to other more familiar pursuits in trade and real estate.¹³

Hirschman here exhibits the difference between the good “industrial” market and the not so desirable traditional market centered on trade and property. The later market suffers from a

¹³ Albert O. Hirschman The Strategy of Economic development P 3.

structural problem with allocating resources. Early development economists realized that the market in most developing nations does not change voluntarily but through pressure and the introduction of new elements into the equation. Hirshman's indictment of the market was not unique but was generally shared with the other mentioned economists.

Nurkse's synchronized approach to balanced development demanded government intervention by definition. His approach requires a planning agency and heavy investment from government. But the most enthusiastic supporter of government intervention and the most vocal critique of laissez-faire economics was Arthur Lewis.

Lewis states that laissez-faire is not suitable to general planning, which is needed, but should be used on the micro level. He scolded those who defended the universality of laissez-faire economics: "there are no longer any believers in laissez-faire, except on the lunatic fringe."¹⁴ The market economy, as has been hinted to by others, is unable to allocate investment 'developmentally'. He argues that the difference between the planning approach and laissez-faire lies not in "rejecting the market economy controlled by demand, but in arguing that demand itself is not sacred, but something that should be controlled by the state."¹⁵ We will see, before the end of this thesis, how this statement is transformed in a way Lewis would have never anticipated.

There were many beliefs underlining early development thinking. The most general was the belief that there was something seriously wrong in the developing world that could and should be fixed by the hindsight wisdom of the developed world. The "capture" of the developing world into development discourse produced a classic Foucaultian/Nietzschean knowledge/power relation, different in form, substance and goal from the colonial experience.

¹⁴ W. Arthur Lewis The Principles of Economic Planning London. UNWIN University Books. 1968. P 14.

The mood of development as a project was hegemonic, but not unchallenged. Voices of dissent within the ranks could be heard early on. Some questioned the goals of development, others its methodology, and others its rationality.

The liberal turn:

Arthur Lewis was perhaps too quick to exile those who believed in laissez-faire to the “lunatic fringe”. He continued to regard development as something resembling industrial capitalism. He never attacked the market as being inherently insufficient for development, but he, like many of his contemporaries, regarded the market with suspicion as the best vehicle for development. The market, it was reasoned, acted in a pre-industrial fashion and acted according to the basic tenets of the market system. Thus the easiest path to profit, which often meant trade and not industry, was the favored path. Lewis and his contemporaries complained of the fact the market in developing nations encouraged agriculture, trade and real estate. This was not development. The developmental process as introduced meant industrialization and the transformation of society by it from something akin to pre-industrialization to full fledged industrialization. This process will re-create societies in a scientific fashion which was as important as creating a valid exchange system. The reordering of society to something more modern was a key feature in development and this feature were thought to be beyond the reach of the market. The realities on the ground were testing the beliefs of industrialization. Most encounters with the west did in fact cause significant changes within the colonized nations. However, these changes, including industrialization, were not sufficiently effective so as to transform the make up of these nations to something more modern. These immediate failures reinforced the call for planning and careful allocation of resources, instead of depending on the

¹⁵ Ibid. P 21.

market to generate such a change. However, these same frustrations were causing other economists to review the process of development and revert back to the market as the governing mechanism of all economic activity including development. A new breed of economist began to question the efficacy of government intervention and of the policy of industrialization.

P. T. Bauer, working within the same time frame as Lewis and the others, was one of those economists who disagreed with prevailing vision of development. The disagreement was born in two places: the experimental and the methodological. Experimentally, development in the 1950s was producing fertile ground for misuse, corruption and waste. Many involved in the process were disillusioned by its practices. Bauer, one of these disillusioned economists, working in India, noted corruption, and inefficiencies within the public sector as major effects of development. Backed by the heritage of classical economics, Bauer reinforced his disdain for the common practices of development with added emphasis on going back to the principles of the market. In its essence, market economics pay little heed to the type of the production process. It emphasizes principles and rules. What is needed is not necessarily industrialization but a functional market system that distributed resources according to rational principles. This market would be the most efficient in discovering or honing an area of competitive advantage that could generate profits and surplus. The state, Bauer argued, especially within the developing world, was inexperienced, inadequate and ill prepared for the tasks assigned to it under development plans. Unlike his other contemporaries, Bauer did not think that the state is the proper organ to bring about the transformations deemed necessary for development to occur: "in the great majority of underdeveloped countries, the political system is unsuitable and the administrative resources insufficient for the effective performance of even the necessary government

functions.”¹⁶ Thus the government wasn’t able to administer its own affairs let alone lead an accelerated industrial drive. The market on the other hand can function best with little interference from the state, and it can govern its own development. Bauer also was friendlier towards the agricultural sector of the economy within developing nations. He disliked traditional agriculture but favored and encouraged the development of cash crops. Unlike Hirshman and Nurkse, Bauer did not believe that agriculture, and especially lucrative cash crops, deprived industry of much needed resources: “quite obviously however, reliance on cash crops does not stand in the way of either cumulative growth or of industrialization.”¹⁷ Thus Bauer reversed the equation. Instead of not trusting the market to bring about development, Bauer advocated the withdrawal of the state from the market so the latter can develop and prosper. The state’s attempt to finance development often, Bauer argued, lead to inefficiency and proved ineffective because it deprived the private market of needed resources: “the state’s activity are not only likely to be beyond its means, but they could have a direct negative impact on what the state was trying to achieve to begin with, namely, investment.”¹⁸ Bauer also regarded investment differently from his contemporaries. Investment was generally regarded as the most important factor of the equation governing the possibility of development. Bauer treated investment as an equal or less important factor among numerous other factors that went beyond the scope of traditional development concerns:

Moreover, it is misleading to think of investment as the only or principal determinant of development. Other factors and influences, such as institutional and political forces, the qualities and attitudes of population, and the supply of complementary resources, are often equally important or even more important. Heavy investment expenditure may result in

¹⁶ P. T. Bauer Economic Analysis and Policy in Underdeveloped Countries London, England. Duke University Press. 1957. p 112.

¹⁷ Ibid. P 103.

¹⁸ Ibid. P 118.

little or no development; and conversely, substantial development may occur with the assistance of little investment.¹⁹

Investment is not the only factor to be considered; although Rostow and most other authors did include political and cultural aspects as influencing development, they all privileged investment economically over other considerations. Bauer, operating from efficient distribution of resources, cared more about return on value than on capital invested. His solution to the problems exhibited in early development practices lay in the extension of the market to other areas of public interactions and in reducing the size and activities of the state. This should allow the market, unassisted, to accomplish what industrialization is supposed to accomplish in overcoming the political and cultural impediments to the market. Bauer does not exhibit a tendency that believes in the universality of development. Although he never states it explicitly, it is suggested in his writings that some cultures are more prone to development than others. This argument was not new. It has been made before and repeated endlessly in different forms and shapes. What is explicit in Bauer's writings is his rejection of the state as a viable instrument of economic activity. The market should be prominent in controlling economic activities. Armed with a resurgent belief in a return-to-principles approach to economic development, Bauer was the first of a generation of economists that would lead an attack against the centrality of industrialization and growth as the mainstay of development and promote the market and market principles as the best method for treating development issues.

The market approach did not win out easily. For one thing, developing countries maintained their industrialization policies. These policies have been partially overcome not because of eloquent and convincing arguments, but because of structural changes in the

¹⁹ P. T. Bauer Economic Analysis and Policy in Underdeveloped Countries. P 119.

international economic sphere that prompted, or coerced, most developing nations to abandon their industrialization drive. In turn, this emphasis on the market appealed to a stratum of traders and landowners who realized the benefits to be reaped from expanded trade and cash crop agriculture. The market approach encouraged traditional economic activities. This meant cash crop agriculture and small-scale production activity found moral support for their practices originating from within development agencies. These activities provided a moral and rational argument against the single-minded obsession with industrialization and capital accumulation. These activities provided the backdrop for a book that bridged, passionately, the gulf between economic and social concerns of development.

The writings of S. F. Schumacher, superior in style and compassion to the rather dry appeals of other development economists, opened the moral ground for a refocus of the efforts towards small-scale production. Schumacher, an economist by training, was existentially distraught with the promise of western development. He failed to recognize the age of mass consumption as the nirvana of development. Instead, he saw within western modernity the roots of dehumanization. Mass industrialization had a stifling effect that stood in the way of human development. Large organizational structures associated with industrialization produced, in his view, an oppressive existence devoid of true satisfaction. In short, industrialization produces alienation. This realization by itself attests to the sensibilities of Schumacher as opposed to the deterministic writings of Rostow and Lewis. Industrialization, in its systematic application of scientific laws, distorts human nature and reduces it to less than its potential: “any organization has to strive continuously for the orderliness of order and the disorderliness of creative

freedom.”²⁰ Here, Schumacher is talking about freedom as an aesthetic quality. It is where the potential of a bound existence gets expressed in immortal acts of creativity. This essential manifestation of humanity gets ignored and destroyed by the orderly aesthetic nature of industrialization. The aesthetic of industrialization would be the same logic, be itself anti-aesthetic unless it is critical in nature. Hence art in an ordering society can manifest creativity only by being disorderly. Or, more akin to Schumacher’s own view, aesthetic creativity is given expression by reverting back to the non-technological past. The past becomes a beacon for resistance. The smallness of developing economies, and the non-industrial nature of their previous production techniques, give rise to another possible avenue for development not yet explored within the literature studied. This line of development would be less interested in factories and more interested in human development. Schumacher does not advocate a policy of de-industrialization, but he insists that society must not be intolerably taxed for the sake of factories. Unlike previous development economists, Schumacher does not view modern industry as the mechanism most suited for developing nations. He argues that, in fact, large-scale industrialization is an inefficient developmental mechanism: “the most striking thing about modern industry is that it requires so much and accomplishes so little.”²¹ Part of what it accomplishes is the destruction of human spirit and beauty. There is no beauty in industrialization, beauty is human, and Schumacher rejects industrialization as a viable work of art: “man is small, and therefore, small is beautiful. To go for gigantism is to go for self destruction.”²² What industrialization does is introduce an unacceptable level of human destruction to the developing world. The introduction of ‘ugly’ industry produces ‘uglier’ results

²⁰ E. F Schumacher Small is Beautiful London, England. Vintage Book. 1993. P 204.

²¹ Ibid. P 95.

²² Ibid. P 131.

that work to counteract the positive contribution of industrialization. He calls this a process of mutual poisoning: “whereby successful industrial development in the cities destroy the economic structure of the hinterland, and the hinterland takes its revenge by mass migration to the cities.”²³ This is Lewis’ salvation brought down to reality. Thus, industrialization does not offer an answer to the developing world. Re-emphasizing smallness does. Schumacher relies substantially on the wisdom of Gandhi; he agrees with him and reiterates his view that “the poor of the world cannot be helped by mass production, only by production by the masses.” Schumacher aims to bypass the problems of industrialization by slowing down the process of gigantism and reintroducing ecology and human dignity into the equation. He proposes the use of ‘intermediate’ technology to strike a balance between the useful side of technology and its dehumanizing effect. The premise for this new technology’s viability lies in the fact that the developing world exists on a different technological plateau than the developed world. Thus the technology of the latter is not the savior of the former. A new technology, made possible by the know-how of the developed world, and made practical by the needs of the developing world, is possible. This intermediate technology would be produced by “making use of the best modern knowledge and experience.”²⁴ It is an attempt to use the new to validate the old. This technology would be conducive to “decentralization, compatible with the laws of ecology, gentle in the use of scarce resources, and designed to serve the human person instead of making him the servant of the machines.” Here, in a paradoxical fashion, Schumacher urges modern technology to create anti-technological machines, which in the contexts of the last few centuries, also means anti-industrial and essentially anti-capitalist, since the growth of modern technology, has been linked with the growth of capitalism. Intermediate technology is being marketed for the

²³ E. F Schumacher Small is Beautiful P 137.

developing world by its aim to rehabilitate the developed world. What Schumacher is doing, and he was neither the last nor the first to do so, is using the developing world as the intermediate technology of the developed world. What Schumacher is thus proposing, and without any prejudice or malice, is the utilization of the developing world as a testing ground to find an existential exit for the nihilistic lifestyle of the developed world. Schumacher does not want to use the imagined time difference between the developing and the developed world to recreate or mimic “England”; instead he wants to use it as a second chance for the developed world. The developing world, in a line of argument similar to Marcuse, and even Fanon, is still the only arena of action left. Industrial order and mass consumption are so extensive in the west that hope there has vanished for a meaningful change. But the third world, the developing world, the colonized world, the yet-to-be-understood world, is the frontier of possibilities. Escobar will much later illustrate how development discourse locates, captures, and develops a discourse, and thus controls the developing world.²⁵ In a similar fashion, I would argue along with Said, Bahba and others that the developing world has been the depositor of numerous unfulfilled Western dreams. It becomes an arena of cruel, ugly, aesthetic experience disguised by mathematics, that aims to produce something coherent in a world devoid of the possibility of fundamental change. The developing world is the mirage of the Western World; other would argue that it is its prostitute as well.

However, what Schumacher did accomplish is to give rise to the moralistic and humanistic sentiments of the West within development discourse. His morality and linkages

²⁴ Ibid. P 127.

²⁵ Arturo Escobar Imagining a Post-Development Era in Jonathan Crush Power of Development New York. Routledge. 1995. P 213.

between freedom, beauty and smallness will be used to legitimize and further the development of dominant economic trends favorable to the global market economy.

Another major contribution of Schumacher, more important than intermediate technology, was the grasp of development as a process that is troubled. His approach allowed non-economic concerns to take on economic values and to be addressed as crucial to the practice and success of development. For the first time, the problems associated with the process of development were being represented as not being necessarily necessary. Poverty, urbanization, shantytowns, and pollution were being viewed, and perhaps for the first time, as being an unacceptable price for economic growth. These issues were to become central within development discourse and their treatment is a matter of great importance to the rest of this essay. Schumacher's willingness to quote Gandhi extensively also indicated a trend of listening to more voices from within the developing world. These voices were not the voices of Nasser, Nehru or Tito, but they were the voices of economists within the World Bank. Much of the developing world, and the development enterprise, were still concentrating on growth and industrialization. Poverty began to make its presence within dominant development circles. The World Bank produced a plethora of compassionate and articulate reports denouncing poverty as an ill that must be eradicated for humanistic and economical reasons. Many of these ideas originated from economists of the south. Jagdish Bhagwati was one of the more influential voices within that Bank that tackled the problem of poverty.

By the time Bhagwati began writing, free market ideas were making a strong comeback. The thinking about the problem of poverty was being done under the guidelines of free market terminology. Much later on, Bhagwati would reminisce that "as regards the objective of development, I should emphasize, as I always have, that growth was seen by me...as simply an

‘instrumental variable’, or a means to an end, and the end was clearly the elimination of poverty.”²⁶ The aim of development for Bhagwati has been from the beginning the elimination of poverty and not necessarily growth. At least in retrospect, Bhagwati was atypical of the development economists by regarding growth as a means and not an end by itself. However, he was typical of the new generation of free marketers who disliked the importance of industrially-led growth in favour of a more market-friendly approach. As has been the case with Schumacher and Bauer, the abuses of development were not justified, and the creation of masses of poor was not seen as an acceptable price to pay for industrialization. Development as has been advocated by Lewis, Hirschman, and Nurske was being challenged. A new hegemonic discourse was beginning to be felt. Bhagwati, among many others, will contribute to this challenge by providing arguments in favor of free trade and limited government intervention in order to spur growth, and tackle poverty. The state, especially the developmental state, was coming under increasing criticism. Unlike Bauer, Bhagwati’s rejection of the old model of development was more sympathetic to the state and more concerned with human cost than with cynicism and disgust. He was attempting to synthesize a human application for development not based on large organizations but on human effort. Schumacher’s criticism of large enterprises as inhumane lent itself easily to free market arguments thereby serving to further curtail the role of the state and enhance competition instead of concentration of resources. Bhagwati, as has been mentioned, did see some relevance to state intervention and even planning, but only as a secondary to the market mechanism:

With regard to the techniques or methods of development, so as to achieve the desired objectives, the approach advocated by me has from the beginning been a blend of planning for ‘key decisions’, land reform

²⁶ Jagdish N Bhagwati Wealth and Poverty Cambridge, Massachusetts. The MIT Press. 1985. P 1.

were required, and a generous and judicious use of the market mechanism.²⁷

This tilted approach balances out the excesses of the market while retaining the efficiency of its resource distribution. Bhagwati does not tackle the problem of poverty directly. He proposes that poverty is the main goal of development. He then proceeds to build a case that supports growth as the main instrument of reducing poverty. In a recent article, Bhagwati reinforced his old positions regarding free market and development. He reiterates that free market economics not only lead to better economic performance and efficient distribution of resources, but it directly relieves the pressures surrounding the most disadvantaged groups in society. Thus, free market policies can “ help pull excluded groups (e.g. women and the poor), into literacy, gainful employment, better health, et al. through first, enhanced ability to finance public expenditures and second, through their direct affect on improving their incentive to achieve greater literacy and health as well.”²⁸ Bhagwati has maintained a long-standing position defending the benefits of free trade, especially for the poor. In the same article, he goes on to argue that countries with free trade policies, especially developing countries, have managed much better than countries that have protectionist policies. Thus, trade and free market economics as the main instrument of development replace industrialization. This replacement takes place on the intellectual front due to the main disagreements with the tenets and results of growth-inspired development. Unlike the earlier generation (who are still contemporaries of Bauer, Bhagwati, and the others to follow), Bhagwati’s aim is not to instill scientific rationality or to change the structure of social production to the same extent as the growth theorist advocated, but instead, he and his generation

²⁷Jagdish N Bhagwati Wealth and Poverty P 2.

aimed to change the thinking of the developing world and agencies to better fit free market economics. Ricardo, and not Marshal or Keynes, would provide the trade generation with their theoretical inspirations.

Underlying this trend toward more free market economics is a different conception of the “developing human being”. This creature is viewed differently by these authors. The “developing human being” is not a unique creature in need of guidance or salvation, nor is he a savor of the West and its existential ills. This creature is universal in nature. No essential difference exists between the developed world citizen and the developing world citizen. The differences that exist between them are constructed. They are caused by interference, distortions, social attitudes, and a plethora of all other sources that do not form an essential difference between developing and developed citizens. Unlike modernist thinkers, the developing countries do not need the destruction of their cultures and environment so that “Newtonian thinking” can take hold. And the promise of scientific rationality via industrialization does not prove alluring either. The developing man, according to Bhagwati and others, is no different than the developed man. Both use maximizing self -benefit as the key to their decision-making and behavior patterns. Thus the system that best fits this individual is the system that uses the maximizing self-interest to generate communal and efficient benefits. T. W Schultz was one of the first authors to back up Bauer’s reiteration of Adam Smith’s dictum; “man is a self maximizing rational animal.”

Theodore W. Schultz was a faculty member of the University of Chicago when he began writing his influential book, Transforming Traditional Agriculture. This book was and remains

²⁸ Jagdish Bhagwati. Economic Freedom: Prosperity and Social Progress.” Keynote Speech delivered to the Conference on Economic Freedom and Development in Tokyo, June 17-18 1999.
<http://www.columbia.edu/~jb38/papers.htm>. P 8.

important due to two factors: The affirmation of the universality of free market ideas and the emphasis on human capital as opposed to physical capital. Schultz, in a display of independent thinking, rejects the emphasis on industry over agriculture and undertakes a study in agriculture to outline the importance of that sector and the lessons that can be learned from it. Part of Schultz's argument is derived from a basic historical observation that agricultural improvements have preceded industrial ones and remain important in most developed countries. Agriculture is not only something to support industry, but it is also a source of wealth on its own. Studying the problems of agriculture allows the researcher to hint at more substantive problems, and solutions, for the economy in general. Human capital is underestimated and utilized. Schultz begins his book with this firm conviction, especially as regards most of the third world: "Presently, in country after country, policy makers are about as sophisticated as farmers who once upon a time planted crops according to the face of the moon."²⁹ This damning introduction in the preface sets the tone for the book. The problems of society in general can be looked at to some extent from studying the forces operating within the sphere of agriculture. And the problem in many countries seems to be a general lack of human capital. This problem is not localized within the illiterate or traditional sector, it seeps from the top. The idea of agriculture as secondary in importance to industry is itself problematic. Schultz, in attempting to reformulate the problem of development, is framing it again within a universal discourse aimed at salvaging historical lessons to be applied successfully elsewhere. History, in Schultz's writing, takes on a similar appearance to history in Rostow's writings. It is an arena to test hypothesis, after the fact, about the effectiveness and ineffectiveness of a certain policy or another. This part is not very

²⁹ Theodore W. Schultz Transforming Traditional Agriculture. Yale University Press. New Haven, Connecticut. 1964. P vii.

problematic, what is problematic is the solution and universality associated with historical lessons. This will be further elaborated later on. Schultz's approach is rooted in studying the problem of agriculture from the vantage point of incentives and return on investment. His approach "treats agriculture as a source of economic growth, and the analytical task is to determine how cheaply and how much growth can be realized from transforming traditional agriculture by means of investment into a more productive sector."³⁰ The aim of Schultz's analysis is to transform, initially, the agricultural sector which is not being helped along as it should be, either by industrialization theories or by traditional forces within the subject countries. What is of interest is his methodology. Unlike modernization theorists looked at earlier, Schultz views the problems of agriculture as stemming from issues related to incentives, and not to traditional cultural values. The problem is economical in nature:

The critical economic question therefore, becomes: under what conditions does it pay to invest in agriculture? The implication is, from what has already been said, that it will not pay unless the man who farms has the opportunity and incentive to transform the traditional agriculture of his forebears.³¹

Traditional agriculture is problematic not because it lacks scientific rationality per se but because it lacks the proper incentives to induce further investments and improvements. Thus in a traditional setting, working extra hours over the usual labor time will not produce an acceptable return on these extra hours. Thus the incentive to come up with new techniques, or to simply work harder, is not there. The pay-off is too little. The role of investment in human capital is to bring about a qualitative change in the productivity of a single agricultural worker without having to demand a substantial level of investment in return. In short, when the incentives to

³⁰ Theodore W. Schultz Transforming Traditional Agriculture. P 4.

³¹ Ibid. P 23.

labor more are sufficiently lucrative, then the farmers will attempt to exploit the situation to their benefit by investing in themselves and in their trade. Human capital does not necessarily mean having modern training and techniques. It means having the proper mindset and skill level to take advantage of opportunity when it arises and to transform the temporary nature of the opportunity to something more stable. For that to take place, some investment from the state is also needed. But this investment is to take place within the human capital front and not in redistributing land, or in changing the techniques of agriculture overnight. The concept of human capital is very important. And the idea that it follows certain laws that can be made to answer to history is compelling.

Schultz points to the success of the Marshall plan after the war in Europe. He states that this came as a surprise to most observers especially following the amount of physical destruction that took place. Schultz points out that these observers had underestimated the human capital potential of Western Europe, which in his view, was much more important than the physical capital destroyed by the war. Vice versa, the optimism that followed the initial aid packages to the developing world can be attributed to the overemphasis on the role of physical capital in the developmental process and the neglect of the human capital aspect. These ideas are compelling and strike a chord with most observers. However, in a paradoxical fashion, Schultz returns at the end of the book to explain the lack of human capital on bases such as government structure, culture, and other factors. The idea is that, essentially, all humans are the same, but structurally, we are impeded by our surroundings. This is the position that he set to challenge at the onset of the book. The main idea is that given the correct package of incentives, agriculture would be transformed because of the inherent tendency of humans to act in a self-beneficial manner. This is akin to the question of why has capitalism failed to develop the third world: because capitalism

never took root in the third world. The answer makes the question redundant. What Schultz's argument amounts to at the end is a re-formulation of the modernist approach to the problems of development. Essentially, they viewed underdevelopment as a symptom of a sick culture. Schultz contribution lies in that he includes the modernist project as a part of that sick culture, but he does not go beyond it to offer a solution to the problem that can by-pass the clash of culture and development. Again, one is reminded of the desire of development theory, in rhetoric at least, to spare the developing world the horrors of development that the first world experienced. Perhaps also unconsciously, none of these authors seem to acknowledge that the horror of underdevelopment itself is related in substance and form to the horror of development, especially Western development.

Thinkers such as Schumacher, Bauer, Bhagwati, and Schultz, among others not mentioned, played an important role in attacking the conception that growth can only be industrial in nature and that the market as a mechanism was somehow unsuitable for developing countries. Schumacher is grouped into this category with difficulty. He did not explicitly advocate a market mechanism for development. His criticism of industrial led growth fit well within the moral objections to development as it had been practiced and advocated. It is worth noting that he was the most radical of the dissenters. The dissent in general was not revolutionary nor was it external in nature. Bhagwati, Bauer and Schultz, as well as Ann Krueger who wasn't looked at but who still remains important in trade theory, all worked, and some continue to work, within development organizations. Ann Krueger is the First Deputy Managing Director of the IMF.³² The disagreement was about the extent and role of the state and industrialization in generating economic growth. The second generation reinforced the idea that

the market works best. The differences exhibited within the developing world are best solved by a more open economic position rather than a policy of industrialization via import substitution or state-led mobilization of resources. Thus Bauer pointed out the overextended nature of the state and emphasis on public and capital expenditure as something that impedes investment and does not generate it.³³ Bhagwati argued that the reduction of poverty is achieved through increasing growth. And this growth is best increased by tapping in to the world system through increased openness to international trade. Schultz reaffirmed the universal nature of economic principles and incentive-based analysis.

The debate wasn't only academic in nature. It was a debate on policy which was decisively won by the second-generation thinkers. Thus Bhagwati can triumphantly declare that even though capital mobility still needs some adjustments, the belief that free trade raises growth and income is a conclusion that "few economist doubt today".³⁴ It is almost amusing to read comments in semi-official publications such as Economic Development and Cultural Change that in "recent years, there has been a vigorous debate regarding the optimum commercial and exchange policies of the underdeveloped countries. One important question of this debate has been that of overvaluation and selective import controls versus devaluation as the proper means to correct an external equilibrium."³⁵ Written as late as 1967 this excerpt puts into perspective the amount of change that has taken place, change that allowed Bhagwati in 1998 to declare without much explanation that free trade and the market mechanism (devaluation) are almost universally accepted today. Thus the change has not been very radical but it has been deep. This

³² International Monetary Fund Officers of the International Monetary Fund
<http://www.imf.org/external/np/sec/memdir/officers.htm>

³³ John Toye Dilemmas Of Development Cambridge, USA. Blackwell Publishers. 1993. P 75.

³⁴ Jagdish Bhagwati. Economic Freedom: Prosperity and Social Progress p 5.

³⁵ Donald Huddler Furtado on Exchange Control and Economic Development in "Economic Development and Cultural Change" Volume 15. Number 3. April. 1967. P 269.

change facilitated, and was reinforced in turn, by the discourse surrounding SMEs. This environment that started off by rejecting the industrial model, developed into an environment supportive to free market changes. The discourse surrounding the role and nature of SMEs as a developmental tool is also a byproduct of the same forces that brought about the change from the first to the second-generation thinkers.

There was nothing in the writings of the second-generation authors that pointed directly to SMEs as a suitable organizational form for development. In general, it is possible to deduce that most of the authors reviewed were somewhat sympathetic to SMEs. Second generation authors were more sympathetic than their predecessors. Schumacher's displeasure with large firms in general and his emphasis on "production by the masses and not for the masses" and intermediate technology all lend itself easily to a hypothesis that favors SMEs as the dominant economic entity within a nation. However, and perhaps in parallel with the dominant economic mood of his time, he did not advocate explicit support for SMEs at the expense of large corporations. He understood the effectiveness of large organizations. His solution was to make large enterprises behave internally like small enterprises thereby rewarding the participant on a personal and financial basis. This is another one of Schumacher's ideas that would be resurrected in the 1970s in a different form but with the same idyllic vision. Bauer also failed to develop a systematic analysis of the role and desirability of SMEs in developing economies. He encouraged them implicitly since they were more likely to exist in areas of traditional expertise such as trading and cash crop agriculture. The same can be said of Bhagwati who advocated trade as a path for development. Both authors explicitly paid tribute to the entrepreneurial spirit of the Lebanese, Syrian, and Chinese immigrant populations around the world and their prominence in trade. Schultz does not dwell on the issue of small enterprises versus large

enterprises for long. He mentions that size is not the issue. It is the perception of the importance of size which leads many nations to favor large firms and agricultural holdings over other forms.³⁶ By falsely equating concentration of resources with high returns, countries commit unjustified acts in appropriating land and, in the process, dispossessing farmers. As a result, both the physical and human capital is depleted since the resources offered by the government are insufficient or misplaced, and the human capital is depleted because farmers lose any incentive to remain proficient at what they do because they have no ownership over either the process or the results.

Changes in global regime of accumulation:

The growth of the market as a governing mechanism for Western economies was long and tumultuous. The end result of the 19th century regime of accumulation was sealed after the Great Depression and WWII. The upheaval that befell the world, and the success in managing the economy upon industrial basis and methods of scientific management, led to the creation of a new regime of accumulation centered around the alliance of government, business, and labor. This alliance that was cemented during the war continued after the war and was instrumental in creating the recovery following the devastation in much of the world. And this system was given the term 'Fordism', after one of its most important founders, Henry Ford. The US industrial system became universal with few modifications. During this period of development, the state was viewed as an essential player. Its role was to maintain order and act to correct the deficiencies of the market. Order was the main role of the state. This kind of economic discourse was intimately linked with the predominate international regime of accumulation. Fordism was the predominate regime of accumulation within the western world. Fordism

³⁶ Theodore W. Schultz Transforming Traditional Agriculture. P 111.

emphasized the importance of order for the economic accumulation. It attempted to limit the risk factor associated with normal capitalism by accounting for most of the inputs needed to generate profits. A virtuous circle was created between the state, capital, and labor.³⁷ Trade was regulated under the international umbrella of fixed exchange rates. The system worked for a while generating what came to be termed the “golden age of capitalism”. Such a consensus began to lose coherence by the late 1960s. Numerous regulation crises led to the failure of the system, which died officially in 1973 with the abandonment of the fixed exchange rate policy by the US. The new system, which emerged, looked quite different. Post-Fordism came to dominate the literature of political economy as the new regulative model of capitalism. The term is in dispute; some argue that capitalism still suffers a regulation crisis, that fordism has not been replaced by any system. What exists is a general rollback of the other two sectors involved in the Fordist compromise for the sake of capital. Thus, labor and the state are rolled back, as capital takes a leading role. Post-fordism intensifies the fordist emphasis on mass consumption and intensifies it by establishing niche market. In such a system, flexibility is the key ingredient. The social structure created by Post-Fordism differs from the old Fordist structure. Class antagonism, which characterized Fordist era, indicated a strict division of authority between workers and management. Labor control over production was surrendered in favor of more political and economic power. Large numbers of workers were needed to maintain production. Control over this labor force was essential. Fordism required guarantees of a stable and loyal labor force.³⁸ In the Third World, this was achieved by reliance on military and authoritarian regimes that used sheer power to keep labor in check. Hence, one could argue that these regimes

³⁷Bob Jessop Post-Fordism and The State in Ash Amin Post-Fordism: A Reader Massachusetts, USA. 1997. P 255-256.

suffered from acute lack of legitimacy. This chronic deficiency was manifested by growing unrest and rebellions.

Post-Fordism introduces a new role for labor. Large numbers of unskilled labor became less crucial. Multi-tasked skilled, or semi-skilled, labor is more important than a large labor force. This new labor force is divided into work groups, which have a much more involved role in production. These work groups are in turn divided into a core group and a peripheral one. The core group is linked to the company and has relative job security; the peripheral group lacks this security and is hired upon a need basis. Their work is usually less technical. Overall, labor's own shop power was substantially increased and was epitomized by the famous Andon lights where Toyota line workers controlled the production line making sure it was running at green, which was near breaking point, as much as possible.³⁹ This increase of worker control over immediate production necessitated new methods of labor control. The establishment of local work groups shifted work responsibility to individual workers. In fact, the Post-Fordist firm's ability to control labor on numerical, pay and functional basis is one of its most important assets.⁴⁰ By lessening the direct management control at the micro level, the firm gains more legitimacy in controlling the overall function of labor. Moreover, the delegation of production responsibility to work groups internalizes control.

The work group itself assumed responsibility for maintaining production. The individual worker was linked directly to the international economy. The performance of the firm was a

³⁸ Alain, Lipietz. Mirages and Miracles- The Crises of Global Fordism. London: Verso 1987. P 72.

³⁹ Raphael, Kaplinsky. Middle Power Internationalism: The North-South Dimensions. Ed, Cranford Pratt, Kingston and Montreal: McGill Queens, 1990, p 129.

⁴⁰ Martha MacDonald. "Post-Fordism and the Flexibility Debate." Studies in Political Economy. 36(autumn 1991). P 180.

direct result of the worker's performance. Any impediment against the firm is an impediment against the workers. Unions and other worker arrangements began to face resistance from the workers themselves, which lead to another development. The resulting change in the worker's role in production initiated a parallel change in the mode of regulation. Institutions supporting labor became legitimate targets for regulation. As if this was not enough, the nature of the division of labor within the firm segregated among the employees. The result was a net decrease in collective action as each side stood to loose with the advancement of the other's interest. This new form of regulation had formal but cosmetic legitimacy unlike the old directly controlling order.

The economic nature of Post-Fordism is another impediment for third world development. It is essentially an integrationist phenomenon. This new relational arrangement allows for more integrated production and inter-sectorial and inter-firm links to grow and strengthen.⁴¹ The economies of scale of individual plants decrease in importance but the overall economy of scale for the firm stays intact or increases. At the micro level, the new production techniques are dominated by flexible computer integrated manufacturing (CIM) and just in time production (JIT).⁴²

But the key factor in the new production method is the system of linking and integrating firms and cross-sectoral production. This integration is synchronized in order to achieve better sales and goals. This means that whatever Post-Fordist production is located in the periphery

⁴¹ Raphael, Kaplinsky. Middle Power Internationalism: The North-South Dimensions. Ed, Cranford Pratt, Kingston and Montreal: McGill Queens, 1990, p 116.

⁴² Michael Dolan, et al. "Power in the 'new' new international division of labor: Third World production in Post-Fordist era." unpub paper, November 1992. P 4-5.

forms a specific role in an integrated global effort. This mobilization of resources is usually aimed at the developed world where the final goods are sold. Hence, offshoot industries and economies of scale are unlikely to develop. The production process in these countries will be increasingly linked to northern economies and to the fluctuations in them. The lack of local emphasis will deprive these countries of a needed cushion once the next capitalist crisis hits. Specialization, integration and flexibility are the key operating words. The South, therefore, becomes more dependent on Northern technology and markets.⁴³ Development of local markets is hindered by this emphasis on the North and by the weakening of labor.

This change in the international regime of accumulation brought with it a change in development discourse. With the changing face of capital accumulation, new visions regarding development began to gain a following. The neo-liberal vision, which emerged in the late 1970s and dominates the established development agencies, regained hegemony. Authors such as P. T. Bauer, who argued that the major problem with development is the over-extension of the state, were given more attention.⁴⁴ Other authors began to look at trade as the essential feature of success. Krueger, Bhagwati and Balassa, among many others, argued that countries operating under a liberal trading regime did best in economic and in export growth.⁴⁵ The neo-liberals had many premises. Some of the more theoretical ones centered on Adam Smith's notion that the market was simultaneously the best generator of wealth and the most efficient distributor. Neo-liberals argued that the state was hindering development. Slow progress experienced by the third world has been a result of excessive government intervention in their economies. Three areas

⁴³ Manuel, Castells and Tyson, Laura d'Andrea. "High Technology and the Changing International Division of Production: Implication for the U.S. Economy." The Newly Industrializing Countries in the World Economy, ed. Randall B. Purcell, Boulder: Lynne Rienner, 1989. P. 15.

⁴⁴ John Toye Dilemmas Of Development Cambridge, USA. Blackwell Publishers. 1993. P 75.

⁴⁵ Christopher Colclough Structuralism Versus Neo-Liberalism: An Introduction in Christopher Colclough and James Manor States Or Markets? New York. Oxford University Press. 1991. P 8-9.

needed to be addressed, these were: the over-extended public sector, the over-emphasis on physical capital formation at the expense of light industry and skills, and the proliferation of distorting economic controls.⁴⁶ In short, the state's role had to be curbed and the economy opened to the disciplining pressure of the Fordist production model based on controlled international trade utilizing large industries and standardized production processes. The internal contradictions of the system, and the inability of the triad to control the system's tendency to push itself to the brink, brought about the end of this arrangement. The resulting system, termed post-fordism, is perhaps better described as a return to market-based principles without making the link with labor. The liberal state and market mechanisms that devastated the 19th century system are back lacking two ingredients, the gold standard and the balance of power system.⁴⁷ The gold standard was built upon the notion of international macro-economic stability. Thus, the current emphasis displayed by central Banks and development economists on wide spread macro-economic stability is an approximation of this model. However, the model suffers from a contradiction. The liberal nature of the system is inherently destabilizing. The system is based on macro economic stability that is brought about by market mechanism and liberal international regime. However, the liberal international regime operating within the auspices of market rationality produces continued instability, especially in the financial sphere. Following the recent crises in East Asia, the IMF failed to find any advice beyond deeper and faster liberalization to a problem that was created to begin with by deeper and faster liberalization.

SMEs come to play an interesting role in this discourse. As opposed to large industrial factories, which were the ideal of the Fordist system, the decentralized rhetoric of the post-fordist arrangement plays well into the make up of SMEs. JIT production and closeness to market also

⁴⁶John Toye Dilemmas Of Development p 70.

⁴⁷ Karl Polanyi The Great Transformation Beacon Hill, Boston. Beacon press. 1944. P 3.

seem to benefit SMEs. The language tying SMEs to post-fordism has been presented in a certain light that seems to illustrate the benefits of the new economy to SMEs only within the context of the larger picture. We will later see how discourse regarding the benefits of SMEs has been conducted on one level with the help of their favorable nature to the new economic system, and on another level linking the very welfare of SMEs to properly functioning market system. Thus, just as the fordist system and fordist production demands were reflected indirectly in development discourse, so will the market-led, liberal tendencies of post-fordism be present in the de-regulation discourse of second-generation development. SMEs serve as a mechanism to illustrate the benefits of the market, and not the benefits of SMEs themselves.

Theories of SMEs and their contribution to economic activity:

The general thrust of the liberal economic argument is sympathetic to the nature of SMEs. The idea of perfect competition lends itself to images of pre-capitalist markets filled with villages and trades-people displaying the results of their labor. Within the first generation authors, this image constituted something to work against. It was a manifestation of the traditional system hindering the development of the necessary industrial infrastructure. It is again a sign of impressive progress to have SMEs gain so much in stature so as to have not one but several agencies dedicated solely to their promotion within the UN development agencies. This change of receptivity did not happen over night. It happened over many years where the rules of generating wealth within the developed world changed and, with it, the explanations of how wealth is optimally generated. Nor was the theory field governing the emergence and receptibility of SMEs barren. Many economists and sociologists theorized about SMEs and about the nature of change within an economy in general.

Perhaps one of the most influential authors is Joseph A Schumpeter. This prolific and original author set the stage for many of the arguments that would be used to propel the academic credentials of SMEs and their importance for the economy. His arguments were not limited to SMEs but involved discussions on innovation and entrepreneurship. Nor was he the first to discuss such issues. The sociology and psychology of capitalism were first analyzed by Marx much earlier on. His description of the capitalist as a persona was not necessarily academic, but it helped bridge the gap between his abstract theory of value and everyday experience. Marx's contribution is his discussion of the bourgeoisie. In his terminology, the bourgeoisie were the engines of growth within the capitalist economy. Being by their nature restless, they are the innovators and expansionists of the capitalist system. The communist manifesto captures the role of the bourgeoisie in simple terms: " The bourgeoisie cannot exist

without constantly revolutionizing the instruments of production, and thereby the relations of production and with them the whole relations of society.”⁴⁸ Thus the capitalist system is a creator and a creature of the bourgeoisie. The ability of the system to develop further rests with the ability of the bourgeoisie to smooth over capitalist contradictions. Marx’s theory was later challenged by other sociologist and thinkers. Max Weber introduced a cultural theory that accounts for capitalist development. In the Protestant Ethic and the Spirit of Capitalism, Weber credits the growth of capitalism not to the bourgeoisie in general, but argues that this growth itself was based on a prior cultural ethic supplied by the emergence and growth of the protestant movement. The protestant ethic translated heavenly reward to inner worldly manifestation mixed with austerity. This transformation allowed the new community to engage earthly vocation mixed with heavenly enthusiasm. The new value system emphasized hard work, frugality, and efficiency.⁴⁹ Both Marx and Weber have attempted to develop a theory of change and continuity within capitalism. Both of these theories can be determined to lie outside of the mainstream economic explanations of capitalism. Neither class nor culture is an adequate unit of analysis for economics. The individual is.

Schumpeter provided an argument based on economic rationality of self-interest to foster the major arguments in favor of SMEs and their role in continuing capitalism. He builds on arguments attributing growth and change in the capitalist system to innovation brought about by the activity of the entrepreneur.⁵⁰ He asks a simple question, for which he also supplies the answer: “ The question is, why is it that at different times, different things get produced? Two reasons, external factors which are beyond the control of the individual producer and internal

⁴⁸ Karl Marx and Friedrich Engels The Communist Manifesto in Irving Howe Essential Works of Socialism. Yale University Press. New Haven. 1986. P 7.

⁴⁹ E. Wayne Nafziger The Economics of Developing countries P 48.

⁵⁰ Joseph A. Schumpeter Business Cycle V.1 NY. McGraw-Hill Book Company, Inc. 1st ed. 1939. P 102.

factors.”⁵¹ These internal factors are changes in “taste, quantity or quality of factors of production, changes in the methods of supplying commodities.”⁵² Innovation takes place in the third element of the internal factors: the methods of supplying commodities. Innovation designates “technological change in the production of commodities already in use, the opening up of new markets or a new source of supply, taylorization of work, improved handling of material, the setting up of new business organizations such as department stores, in short, any ‘doing things differently’ in the realm of economic life.”⁵³ The Entrepreneur is the leader of innovation, which in turn, is the key to change and growth in the capitalist system. The entrepreneur carries out new economic innovation by affecting the economy in five different fashions:

- 1) Introduction of new products.
- 2) Introduction of new production functions that decrease inputs needed for a certain output.
- 3) Opening new markets.
- 4) Exploiting new sources of material.
- 5) Re-organizing industry.⁵⁴

Thus the entrepreneur is the engine of capitalism, however, modern industry, at least as far as Schumpeter was concerned, was suffocating the possibility of entrepreneurship with its monopoly power and over-centralization and focus on management instead of innovation. An entrepreneur may have managerial ability, but is an entrepreneur due to the virtue or risk taking. An environment which encourages and rewards successful risk taking is more likely to produce a growing numbers of entrepreneurs. The type of development being advocated by early development theorists was essentially anti-entrepreneurial. It was based on importing invention

⁵¹ Ibid. P 72.

⁵² Joseph A. Schumpeter Business Cycle V.1 P 73.

⁵³ Ibid. P 84.

instead of creating innovation. Thus the emphasis on capital accumulation exemplified by the Harrod-Domar model, Hirschman's unbalanced growth, and Nurkse's balanced approach essentially emphasizes the importance of importing capital from the developed world rather than developing indigenous innovation. The thinking was that large scale industrial activity, mixed with planning, is probably the best and quickest way to development. This emphasis on capital accumulation was done with little attention to market principles and normal market incentives such as profits. This had been the base for the second-generation criticism of the initial development project. Schumpeter seems to agree, or the second generation agrees with Schumpeter, that the motivating factor for an entrepreneur is the promise of opportunity. For opportunity to exist, many other factors must be available as well. Resource accumulation based on early development model fails to sustain economic changes. The dependence on natural resource, and on capital intense production does not create a sustained internal market. Thus, opportunity is lacking and completely dependent on innovation being done outside, where a market, or opportunity, for the capital intense machinery being acquired is available. The problem was being addressed by a plethora of import substitution strategies that soon become the target for internal and external criticism. The role of innovation in sustaining and expanding development economies was limited. As we will see later, learning, instead of either innovation or invention, is the strategy most suitable for late industrialization. However, within the context of entrepreneurialship, the economic activity in the developing world was not promising. Early development authors were not blind to this problem. The repeated calls for a change in the mindset of developing populations were a hint that these authors saw that whatever entrepreneurial activity existed within the developing world worked in an opposite direction of industrialization. Hirschman and Nurske were very conscious of the need to expand the

⁵⁴ E. Wayne Nafziger The Economics of Developing countries P 313.

industrial activity to reach a wider section of the population in order to generate a sustainable economic momentum. To achieve this goal, the two authors advocated a mix of planning and market instruments to bring about growth. The idea was that developing countries lacked some of the institutions that made innovation-driven entrepreneurship difficult. Finance especially was, and still is, desperately needed. Even at a more basic level, problems with infrastructure, communication facilities, and effective legal institutions were all lacking to some degree or another. Thus to advocate a policy based on free markets and SMEs without these institutions was regarded as problematic by many of the first generation authors. Second generation authors were less inclined to be deterred by institutional poverty. Essentially, free market theory postulated that these inputs could be purchased on the market for an appropriate price.⁵⁵ Thus the second-generation writers did not concern themselves with institutional strengthening, which came back at a later date to dominate liberal World Bank views, but instead, focused on centralizing the market as an instrument of control and resource allocation. These authors devoted little attention to entrepreneurship in the developing World; Bhagwati notes that with regards to entrepreneurial ability “there seems little room for pessimism.”⁵⁶ This optimistic declaration is followed up with continuous remarks regarding the role of culture, skill, administration and national character to the development of entrepreneurship. These serve to remind the reader that ability by itself is not sufficient but it is a necessary attribute to entrepreneurship. Thus entrepreneurial ability is available but not in the modern sectors of the economy, an oxymoronic conclusion. Bhagwati continues his optimistic analysis by indicating that despite the tendency of entrepreneurs to engage in non-industrial activity, they do turn to industrialization once the hazards are reduced.⁵⁷ Bhagwati’s analysis is lacking. Using

⁵⁵ E. Wayne Nafziger The Economics of Developing countries P 316.

⁵⁶ Jagdish Bhagwati The Economics of Underdeveloped Countries World University Library. London. 1971. P 79.

⁵⁷ Ibid. P 81.

Schumpeter's criteria for entrepreneurship and the role it plays in an economy, Bhagwati seems to have missed the point. What Bhagwati describes as entrepreneurship activity in developing countries is not entrepreneurship as understood by Schumpeter; Bhagwati is describing the enterprising capacity of developing countries, and not their innovative capacity. Schumpeterian entrepreneurship is a capitalist category based on institutions of profit making, technical abilities, institutional maturity, and the ability to withstand, and instigate, change. Entrepreneurship is at once a creator of capitalism and a creature of it. And Schumpeter was highly doubtful that this system could sustain itself much longer. For him, the age of entrepreneurship was at an end. For early development economists, the time of entrepreneurship and innovation was yet to come. For second-generation economists convinced of the benefits of incentives, it was something to be tapped.

As a system of growth, entrepreneurship is dependent on successful capitalism. Entrepreneurship also has the dual identity of systematized rebelliousness. This simply means that entrepreneurship as a system of innovation is based on taking risks in a specific environment where there is opportunity. As such, it is rebellious since it seeks to change a specific element of production process. However, the rebelliousness, which is individual in character, is systematized through an elaborate system that involves banks, industries, well-developed systems of production, a cultural setting that encourages or discourages such practices, and most importantly, an ability to systematize the individual nature of the successful change over a wide range of industries or over a dominant section of an industry. This Bhagwati fails to realize during his brief discussion of entrepreneurship. Hirschman and Nurske saw the nascent need for such a system in an economy, but Bhagwati and Schultz both failed to see it. What they, along with Bauer, point to is the enterprising nature of developing society, a necessary but not sufficient condition for entrepreneurship. What they saw can be termed reactionary

entrepreneurship. Simply stated, the enterprising nature of entrepreneurial activity in the developing world can actually have anti-entrepreneurial tendencies since it will most likely promote trade and cash crop agriculture at the expense of industrialization, which has the most opportunity for entrepreneurial activity. However, other economists disagreed with the uninvolved proclamations of second-generation authors regarding entrepreneurship. E. Hagen, writing in the 1960s and early 1970s, disagreed with Bhagwati's pronouncement that there seems little room for pessimism regarding entrepreneurial abilities in the developing world. Hagen used psychology to help his economic analysis of entrepreneurship. He argued that the psychological and sociological factors governing traditional societies produced children with authoritarian tendencies with a low need for achievement and with a high need for submission and dependence. With the development of society, and the incursion of new economic systems replacing the old, things begin to change. The end result that leads to the production of entrepreneurship is the failure of the father economically, and the delight the mother shows in the economic achievement of the son, coupled with the low possibility of advancement in secure fields such as government, which all create an entrepreneurial spirit in some of the offspring.⁵⁸ This theory is limited and flawed on many levels, but it does illustrate that there was a perception regarding entrepreneurship which differed from that advocated by the second generation authors when it comes to developing countries.

Others emphasized the social aspect of entrepreneurship, not in cultural terms, but in the ability of the system as a whole to encourage and capitalize on entrepreneurship. Others, viewed even this version of events as suspect. Galbraith in his comments on capitalism has mentioned that there "there is no more pleasant fiction than that technical change is the product of the matchless ingenuity of the small man forced by competition to employ his wits to better his

⁵⁸ E. E. Hagen How economic Growth Begins: A Theory of Social Change in Peter Kilby "Entrepreneurship and

neighbor. Unhappily, it is fiction.”⁵⁹ Galbraith, and many other economists, emphasized the importance of social change as a whole, instead of crediting individuals with leading the industrial charge. Even Schumpeter does not hold that the entrepreneur is a specific individual credited with keeping the system heroically alive: “nobody ever is an entrepreneur all the time, and nobody can ever be only an entrepreneur”.⁶⁰ Thus entrepreneurship is a role, a phasing role that people can come into and out of as the situation dictates. It is separate from the capitalist in that, often, the entrepreneur is a leader in change, but he/she does not have to be the owner of the means of production. This according to Schumpeter is where Marx failed. He failed to distinguish between the roles associated with ownership and the ones associated with leadership.

The discrepancy between Galbraith and Schumpeter is illustrative of the divisions present in the economic field towards the importance of the entrepreneur. Whereas Schumpeter makes the role of the entrepreneur indispensable for capitalism, many other economists view entrepreneurship as a much less important phenomena in economic development. Instead, the conditions of entrepreneurship, and of general economic activity, are much more important factors. These conditions can be divided into two general categories: market incentives and the availability of capital.⁶¹ Thus societies with stagnate economies offer limited incentives and lack sufficient capital accumulation to create substantial entrepreneurship.⁶² In regards to development, entrepreneurship became more important during the 1960s and 1970s. Its dynamic nature was becoming recognized although views continued to diverge within development discourse as to its importance. Bhagwati, and many economists within the World Bank and IMF, saw it as a marginal factor. The real issue was the development of the market and freeing trade.

Economic Development”. New York. The Free Press. 1971. P 135-136.

⁵⁹ J. K. Galbraith American Capitalism: the Concept of Countervailing Power. Boston. Houghton Mifflin. 1956. P 25.

⁶⁰ Joseph A. Schumpeter Business Cycle V.1 P 103.

⁶¹ Paul H. Wilken Entrepreneurship: A Comparative and Historical Study New Jersey. ALEX Publishing Corporation. 1979. P 7.

The language of entrepreneurship that gave the theory a second life so to speak was influenced not just by development experience, but also by the growing attention to the topic in Western circles. This discourse would utilize Schumpeter's theory to give rise to a plethora of views surrounding entrepreneurship that have much in form though little in substance to what Schumpeter was talking about. This new synthesis is best summarized by Martin Binks and Philip Vale, who attempted to clarify the role of entrepreneurship to economic activity: "implicit in the rhetoric of speakers encouraging entrepreneurship and small and new businesses in particular, is the suggestion that their proliferation would increase the aggregate amount of enterprises within the economy and that enterprise is, in some unspecified sense, good for the economy. It would be inferred from this that enterprise promotes economic development, growth, employment generation and social welfare simultaneously." ⁶³

Irrespective of the nature of the synthesis offered by later SME theories, entrepreneurship is of vital importance to the sustainment of high levels of economic activity once an economy is sufficiently developed; innovation, or changes in the methods of supplying products, is paramount for economic development. Marx, as has been mentioned, termed those responsible for this activity the bourgeoisie. Schumpeter called them entrepreneurs. The bourgeoisie are a class; entrepreneurs are individuals, systematized individuals. This individual is important to capitalist development, equally important is the mechanism through which this individual operates, SMEs.

SMEs are subject to several economic definitions. Some are in direct competition to each other. These definitions get drafted and applied according to the specific problems being faced and specific role being attributed to SMEs in solving such a problem. These definitions are vital

⁶² Ibid. P 8.

⁶³ Martin Binks and Philip Vale Entrepreneurship and Economic Change Berkshire, England. McGraw-Hill Book Company. 1990. P 1.

in development issues such as growth and poverty. The flexibility in defining SMEs bypasses many of the competing roles and is incorporated in a structural discourse that reaffirms benefits, and needs of SMEs regardless of size or function. The main contradiction in SME theory is the dual vision of this entity: universality and uniqueness. On one hand, SMEs are just firms like any other firms; on the other hand, SMEs are not just firms but possess certain special attributes that are intimately linked to entrepreneurship, and many other benefits that are best achieved through SMEs. The inherent importance of SMEs extends beyond the economic sphere to the social one. However, the importance always begins in the economic sphere. An SME is a firm, and as such, it is governed by the relationship that governs the market. A firm has a specific economic function that justifies it: “most new firms are founded with an idea and for a definite purpose. The life goes out of them when that idea or purpose has been fulfilled or has become obsolete.”⁶⁴ The life span of a firm is governed by the birth of an economically variable purpose and ends when this purpose is no longer in demand or has been fulfilled. As an economical model, the small firm is ideal. It is an idea of something ideal that exists in markets determined by two firms, or three firms, or n firms that are equally proficient and equally rational. But because small firms exist in a market place, and because they are very sensitive to all the factors of production in the market place, small firms are unique in several ways. Moreover, as the carrier of entrepreneurship, the firm becomes universally unique. Universal in being an organism that has a known purpose but that is full of potentiality as to how the purpose gets achieved. Theoretically, the entrepreneurial firm could at any time destabilize the economic system as a whole and create a new paradigm of production. It is this function of SMEs, more than any other, that leads SME theorists to declare the uniqueness of SMEs. The unique side of SMEs also designates by default the unique nature of large firms as well. The debate between

⁶⁴ Joseph A. Schumpeter Business Cycle V.1 P 94-95.

the two unique universals has been about size. Concerning economic attitude, size definitely matters.

Capitalism and free markets are not synonymous. Capitalism is a system of private ownership based on innovation arrived at through further improvements in the labor process. Free market refers to a system where transactions are subjected to a system of checks and controls that govern the operations of all the players based on the same principles. Capitalism works best within markets, and as such, constructs these markets. The level of freedom of transaction within these markets is always a matter for debate. Adam Smith describes a world where economic transactions are disciplined by the self-interest of all those involved in the circuit of capital. Marx, upon seeing the much-developed form of industrial capitalism, postulated another theory. He saw that accumulation is based on exploitation of labor, and as such, he saw capitalism as a system always aiming at, and always failing to reach its maximum potential. The moment of maximum exploitation (that of life) is at the same time the moment that capitalism ends since without the exploited subject, it cannot exist. This contradiction pushes the system to the brink at all times. Because capitalism is based on control of the production process, this tendency leads capitalists to accumulate more and more productive capacity. This tendency to increase productive capacity leads to the growth of larger and larger enterprises at the expense of smaller ones. This concentration on capital leads to repeated periods of over-production and brings the system to the threshold on a repeated basis. The bourgeoisie, who ushered in this system and who maintain it, eventually get eliminated from much of the system through the repetitious cycle of brinkmanship. The Schumpeterian entrepreneur has a similar dim fate: “since capitalist enterprise, by its very achievements, tend to automatize progress, we conclude that it tends to make itself superfluous – to break the pieces under the pressure of its own success. The perfectly bureaucratized giant industrial unit not only

ousts the small or medium sized firm and expropriates the bourgeoisie as a class which in the process stands to lose not only its income but also what is infinitely more important, its function.”⁶⁵ Capitalism has a tendency to develop large enterprises whose success causes their own downfall. Other economists also pointed to the tendency of enterprises to get larger and better organized. Technology, by its very nature and requirements of compartmentalization, subdivisions, and specialization, forces industries to follow similar organizational structures.⁶⁶ These compartments endow the enterprise with certain advantages that are related to size. Large enterprises have 5 features that make them attractive:

- 1) Innovation: requires high fixed costs.
- 2) Only firms large enough to attain at least a temporary market power will choose innovation as a method to maximize profit.
- 3) R&D is risky.
- 4) Scale economies in production may also provide scope economies for R&D.
- 5) Innovation that reduces costs results in higher profit margins for large enterprises.⁶⁷

The theory of economies of scale was prevalent with early development theorists. Capital accumulation was a buzzword that included everything from building roads to creating mega industrial projects. Capital accumulation was related to industrialization which would be best achieved through the creation of key industries that will spin off benefits. The association with efficiency, organization and scale were not absent on the participant and it was realized that “advantages of scale lie with manufacturing industry which by its organization and specialization aims at mass production through increasing efficiency and the application of power.”⁶⁸ This industrial bias and; consequently size bias began to be challenged with the arrival of the second

⁶⁵ J. A Schumpeter Capitalism, Socialism and Democracy New York. Harper and Brothers. 3rd ed.; 1950. P 134.

⁶⁶ J. K Galbraith The New Industrial State in “The Galbraith Reader” Macmillan of Canada. 1977. P 281.

generation on the scene. The attack on planning and capital accumulation included attacks on industrialization and size. Schumacher was one of the more eloquent and humane attackers. His pleas against size rested not on efficiency grounds but on human basis and concerns. Later theorists studied were much more concerned with the lack of emphasis on the market as a regulating principle. Their support for SMEs was incidental and not specific. As a rule, these theorists did not attribute any special consideration to size issues. Economists interested mainly in SME development are a relatively new breed. These began to become vocal during the mid 1970s and continued to gain importance throughout the 1980s and early 1990s. Their theory of SMEs rested on the later unique position vis-à-vis innovation and job creation. Zoltan Acs, a prolific SME theorist outlines some of the general advantages and benefits of SMEs. With the help of hindsight, Acs outlines the arguments favoring SMEs. These are:

- 1) Management: different management styles in the globalized economy favor SMEs.
- 2) Innovation as an activity flourishes more in less bureaucratized settings.
- 3) Research is much more important for SME since it constitutes a bigger portion of activity within an SME than it does within a large enterprise.⁶⁹

The first factor relates to efficiency and sociology. The assumption is that SME management style is heterogeneous and as such allows for different styles of thinking. Bureaucracy institutionalizes behavior. Management styles that are less institutionalized are less likely to turn dogmatic. On the efficiency side, SME management is presumed to be able to respond quickly to changes in the global economy. Thus response time and flexibility are both enhanced.

The second benefit, innovation, incorporates the third point. The second point essentially reiterates the theory that an entrepreneur introduces innovation and the third point explains why

⁶⁷ Zoltan J Acs in Small Firms and Economic Growth in Acs, Carlsson and Thurik (eds) Business in the Modern Economy. Cambridge, Massachusetts. Blackwell Publishers, Ltd. 1996. P 27.

⁶⁸ Alan B Mountjoy Industrialization and Developed Countries P 69.

this entrepreneur should be found in an SME. Simply stated, innovation and not production is the presumed activity of SMEs. The advantages of smallness are numerous. Other than flexibility, small enterprises are more likely to be more dependent on innovation, and as such, more likely to engage in it.

The three points mentioned by Acs, innovation, efficiency, and culture are the three most general categories that are reported in the literature. It is difficult to successfully separate the three since they are interlinked on many levels. We will however attempt to analyze each point separately.

- Innovation: as has been mentioned, innovation is the engine of capitalism, at least Western capitalism. Schumpeter has ascribed this function to the entrepreneur who in turn has been linked by Schumpeter and others to the SME. The importance of innovation in changing production method and process cannot be understated. The term innovation must be separated from invention and ‘things’ in general. The term does not designate the creation of new things, but more importantly, the term designates “opening up of new markets or new sources of supply, Taylorization of work, improved handling of material, the setting up of new business organization.” This exhaustive definition sheds light on the importance of an expanded definition of innovation. The expanded definition emphasizes things such as transportation, coordination, organization, access to markets and other aspects. SMEs, due to their intimate nature and market dependent activities, are considered to be in a good position to capitalize on these factors of production which require less R&D and more connectivity with the structure of the local economy. Roy Thurik outlines many features promoting SMEs. Five features associated with this market definition are:

⁶⁹ Zoltan J Acs in Small Firms and Economic Growth P 27.

- 1) Transportation: closeness to suppliers and customers.
- 2) Market size: emphasis on niche markets.
- 3) Adjustment: the cost of adjusting output is cheaper for smaller firms than it is for larger ones.
- 4) Effectiveness: producing things more connected with the needs and desires of the immediate market.
- 5) Control: entrepreneurial control accounts for more motivation at a lower cost.⁷⁰

These factors are more advantageous for small firms. Changes in the global economy since the 70s seem to lend support to these categories. Small firms seem better positioned theoretically to operate in the localized globality of new capitalism. Timeliness is one of the most important competitive advantages that can be said to belong to local SMEs.

Efficiency and innovation are interlinked on many levels, the same attributes that makes small firms innovative makes them efficient with an additional benefit: entrepreneurship.

- Efficiency:

The association of SMEs and entrepreneurship is made on frequent, but not always solid basis. In this association, managerialism and opportunity become paramount. Thus SMEs act with more passion and energy than large firms. However, urgency and managerial capacity, welcomed as they are, is not the mainstay of entrepreneurship. That, as has been repeated many times, is innovation. The distinction is important because it helps distinguish categories and thus associate proper names to proper objects. This way, we will be able to better assess the claims and benefits associated with SMEs and entrepreneurship, especially in developing countries. Policies that support managerial competence or reduces the high level of dependence in SMEs might not necessarily be the same policies that are appropriate

for promoting innovation. Without making these fine distinctions, attributes get lumped together justly or otherwise regarding SME claims.

- Culture:

Culture relates to the other two features in 4 distinct methods:

- 1) As a system that promotes entrepreneurship.
- 2) As a system that inhibits entrepreneurship.
- 3) As an arena where SMEs could make valuable economic contributions, especially related to jobs, in a way which is in sync with dominant cultural habits.
- 4) As an arena where SMEs would make contributions, again especially regarding employment, in a way that is not culturally neutral.

E. Hagen viewed the general cultural characteristics in the developing world not to be conducive to entrepreneurship. Bhagwati, Bauer, and Schultz all implicitly disagreed with his analysis. There is a tendency then to link social practices and the likelihood of entrepreneurship. These social networks again thrust the entrepreneur as a social creation. Schooling, previous background, culture and religion seem to play some sort of a role in determining the general adaptability of a region to entrepreneurship. However, the basis for entrepreneurship is western. This creates a problem since no one has attempted to amend the characteristics developed by Schumpeter. Instead, more business-like characteristics, devoid of much cultural emphasis have been added. Thus it is implicit that entrepreneurs are somewhat of a special breed. However, once again, it is instructive to be reminded of Schumpeter's dictum that one is never an entrepreneur for life. There needs to be a distinction between the role and the individual, a distinction that is getting blurrier as time goes by. This lack of distinction, and implicit

⁷⁰ Roy Thurik Small Firms, Entrepreneurship and Economic Growth in Acs, Carlsson and Thurik (eds) Small Business in

assumptions regarding SMEs, are the basis for cultural friction when it comes to implementing some SME support programs in much of the developing world.

In many developing nations, indeed in many places all over the world, employment is always in short supply, or so it seems. Thus the role of SMEs in generating employment is seen to be one of the better benefits associated with these organizations. Acs attributes most of the growth in US employment to SMEs and not large enterprises. In fact, ever since the mid 1970s, the number and economic importance of SMEs has been steadily growing.⁷¹ Furthermore, the jobs being created are also supposed to be more rewarding in many sectors. Thus we see that some authors associated with flexible specialization celebrate the arrival of decentralized work centered around SMEs as a semi return to the artisan work that was more common in 18th and 19th century capitalism. This association, especially made in places such as north Italy, utilizes a cultural image of a serene pass in order to promote SMEs on a subconscious level as a form of organization more authentic to the region in question. This image has been alluded to earlier by Schumacher who proclaimed the entrepreneur as the “man of creative freedom”.⁷² Culturally speaking, the introduction of SME support programs and micro-finance projects to many areas in the developing world is often a welcomed phenomenon. Thus, the local attitude towards such ventures can be very positive and the return can be positive as well. However, failure, or aggressive implementation of cultural programs aimed at facilitating acceptance of SME culture, could produce problems. The World Bank had many problems due to limited input from women and marginalized groups in many of its development projects. Approaches to foster business ethics in culturally sensitive environment might also backfire. Thus culture plays an important role in supporting or hindering the development of SMEs. This is especially true when the

the Modern Economy”. Cambridge, Massachusetts. Blackwell Publishers, Ltd. 1996. P 134-40.

⁷¹ Zoltan J Acs in Small Firms and Economic Growth P 16-15.

⁷² E. F Schumacher Small is Beautiful P 204.

model of an SME and of an entrepreneur is one-dimensional and based on the rationalistic self-individualistic model advocated in the West.

The hero image of the SME and entrepreneurs in general play into favorable Western notions of heroism centered on the market place. The extent of the benefit, especially of flexible specialization, is debatable. Not that the contribution of SMEs is negligible, but that the irony of systematic production of heroes often goes unnoticed. The hero, the loner, the individual doer is translated into the man of creative freedom by a process. As a product that is supported by many factors, including a favorable cultural position to begin with, the hero loses some of the attributes of heroism. However, the importance of SMEs and their potential to the economy should not be underestimated. Their contribution to job creation has not gone unnoticed. Thus SMEs are being promoted not so much for their innovative potential, but for their employment potential. Production by the masses is a vision shared not only by Gandhi and Schumacher, but also apparently by the World Bank and even the IMF. Within this capacity, SMEs are promoted to fill gaps in rural employment and create opportunities beyond the public sector. The emphasis of early SME initiatives by development agencies, such as the World Bank, has been dominated by employment and poverty reduction. These are still declared goals of these agencies which have been supplemented with other declared objectives such as establishing a business culture and establishing a system that is hospitable to SMEs in general.

SMEs In Development:

Within development circles, the emphasis on SMEs began with poverty. Growth was becoming problematic as a process and as an intellectual strategy. The World Bank (WB), and later the IMF, among many other agencies, began to view poverty as the major goal of development. Growth was seen as a partial solution. With the shift in discourse within

development, planning and industrialization became suspect methods for advancing national well-being. The emphasis on these two arenas came at the expense of rural areas and agriculture in particular. Thus the early SME programs were inspired and linked to rural development and poverty reduction schemes. The change from growth to poverty, as the major occupation of the Bank, was accomplished under the auspices of Robert McNamara. This controversial WB leader gave the Bank a new lease on life by increasing its role in development and opening up new “markets” for the WB products. By the mid 70s, the Bank had become “the largest single external source of funds for direct investment in agriculture in developing countries.”⁷³ Around the same period, McNamara was outlining the Bank’s view that growth hasn’t solved the problem of poverty. Growth, he states, “is not equitably reaching the poor. And the poor are not significantly contributing to growth. Development strategies, therefore, need to be reshaped in order to help the poor to become more productive.”⁷⁴ This short statement illustrates that poverty issues for the Bank had ceased to be secondary and have become to occupy a central position. The problems with growth as has been practiced in development circles were systematic. As McNamara states, growth as a strategy has failed the poor. Problems with this strategy were systematic and required a changed in direction. The problem requires new development strategies that aim at helping the poor escape poverty by becoming more productive. Thus poverty is to be eliminated by increasing productivity instead of increasing welfare provisions. Since the bulk of developing countries populations were located in rural areas, the Bank chose rural development as an initial and continuous goal for itself. The first problem associated with rural development stems from the emphasis of traditional development strategies on industry rather than agriculture. Macroeconomic policies promoting industrialization such as price

⁷³ International Bank for Reconstruction and Development The Assault on World Poverty Baltimore. The World Bank. 1975. P 4.

⁷⁴ Ibid. Preface, P. v.

controls on food, fiscal incentives and government expenditure are heavily skewed in favor of urban and industrial areas.⁷⁵ On the other hand, policies that ensure a flow of field tested technical knowledge relevant to small scale production were not being pursued and were deemed essential for the success of these sectors. The Bank outlines the guidelines of desirable approaches within a framework of rural development:

- 1) Central leadership and coordination: rural development must have the political support of the government as a national goal.
- 2) Decentralization and local participation.
- 3) Research since more technical knowledge is needed.
- 4) Training: the Bank singles this out as perhaps the “serious obstacle to large-scale rural development.”
- 5) Intermediaries: farmer groups and cooperatives.⁷⁶

These five characteristics are supposed to form the backbone of a strategy to increase rural productivity, but the methods the bank chooses to bring these about are questionable. With these in place, the strategy can come into play with the promise of results. These results would be a product of the benefits associated with small-scale production. These benefits can be linked to locality, employment and efficiency. Employment gains, one of the most desired effects of SMEs, will increase the amount of disposable income opening up new untapped opportunities. These gains are dependent on the fact that small-scale farmers are more efficient at utilizing on-farm resources. These increases in productivity, over the long run, are supposed to achieve a rural growth rate of 5% making the rural sector a contributor to economic growth.⁷⁷ However, the strategy to be followed is dependent on appropriate change on the national level. These

⁷⁵ International Bank for Reconstruction and Development The Assault on World Poverty P 6.

⁷⁶ Ibid. P 9.

⁷⁷ Ibid. P 12.

changes involve at least a re-thinking of some of the incentives used to promote growth and government/market relations. Fiscal policies, which generally aims to support urban populations generally punishes the rural areas. This, coupled with the unwillingness of the government to charge on publicly financed investment in rural areas. The aim is to develop a more market based approach governed by incentives and cost benefit analysis.⁷⁸ The same holds true for land policies. The Bank acknowledges that land reform may be necessary in some cases; in many other cases however, small holders can increase their income considerably without land reform. This could be done in densely populated areas or by participating in resettlement schemes. Equally important is the distribution of other resources such as water between rural and urban areas in favor of the later.⁷⁹ Technology is also important. Inadequate research and inappropriate technology aggravate the disparity between rural and urban areas making the process of mutual poisoning more intense. Risk improving innovations and more research are needed to make rural development viable.⁸⁰

The thrust of rural development as outlined by the Bank in this report was to create a new development process aimed not at industrialization but on rural development. The aim was to alleviate poverty and generate growth by bringing more people into productive activity. The methodology involved government commitment for changes that conform more to market principles and less to planning. The emphasis on reducing rural poverty through the encouragement of smallholdings continuous today. But it cannot be termed promotion of SMEs in general. SMEs operate within a market. One of the problems of rural development was a lack of market mechanism. The WB's work on poverty led to branching out to SMEs as appropriate vehicles to tackle the issue and produce more wide spread economic benefit.

⁷⁸ Ibid. P 30.

⁷⁹ International Bank for Reconstruction and Development The Assault on World Poverty P 31.

⁸⁰ Ibid. P 32.

The first official foray into the SME domain was still governed by employment and poverty. The goal in the developing world was not sustaining change, but creating it. This was made clear in the 1978 WB report regarding the role of SMEs in development. The study titled Employment and Development of Small Enterprises addressed the issues of employment and not innovation. The Bank wanted to promote SMEs as an instrument in reducing unemployment controlling poverty. In order to successfully allow SMEs to play their employment-generating role, 4 things were viewed as paramount:

- 1) The most important method of benefiting the great mass of the urban population is by expanding the effective demand for labor.
- 2) Small enterprises typically provide more jobs and investment than larger ones, especially in services.
- 3) Small enterprises are subject to handicaps stemming from government and institutional policies and inherent weaknesses.
- 4) The Bank studies many measures to help mitigate against these difficulties.⁸¹

The Bank found issues hindering the progress of SMEs. Lack of entrepreneurship did not rank high on the list, in parallel to earlier development views expressed by second-generation authors. Finance, however, was on top of the list. The early Bank study realized that structurally, SMEs in developing countries faced numerous problems. The Bank's solutions were geared towards policies that deviate from industrialization and refocus efforts in a new direction. The existing direction of policies, especially policies designed to promote industrialization normally had a negative effect on SMEs. The first of these problems existed in the institutional credit setting.

⁸¹ The World Bank Employment and Development of Small Enterprises Washington, D. C. World Bank. 1978. P 52.

Institutional credit in developing countries of low interest rate loans or subsidized power and water, often benefited large firms more than small ones and created a flow of services to the large firms at the expense of small ones. By attempting to target SMEs, government can mitigate against these negative affects of over emphasizing large industries. A very important step in this process is redressing the balance in charging market value for these services thus making large firms less attractive to receiving these services. The institutional bias against finance for SMEs perpetuates the existence of informal credit outlets such as curb markets and moneylenders. These individuals offer needed services but at very high rates, they are an inefficient way to deliver credit. These outlets also suffer from limited market reach and an inability to provide diversified products. SMEs are further handicapped by collateral requirements and by proper accounting methods. The end result is that financial institutions, public and private, exclude or limit the amount of loans extended to SMEs.⁸² The Bank was aiming to change that bias by channeling more resources into SME specific programs and broadening the range of these loans and by tapping in to all the available channels of finance such as formal, intermediaries, and informal sources. The aim was to standardize the approach and create adequate price mechanism to dissipate capital, technology, training and entrepreneurial capability. The Bank's plan and study is thorough, thoughtful and eloquent. The Bank's strategy although not specifically spelled out to the same extent that it will be later on, is centered around the notion of 'getting the price right'. Subsidies are regarded as self defeating and are not an advisable strategy:

Further subsidization of interest rates for SSEs (small scale enterprises) would be self defeating, partly because it could limit the amount, and require rationing of credit resources; this could accentuate the role of favoritism in the distribution of such credit. In addition, it could encourage more capital-intensive production patterns and discourage saving and reinvestment among those small entrepreneurs who obtain subsidized loans. Moreover, the lending institutions should seek to attract individual savings as an

⁸² Ibid. P 30-36.

increasingly important part of their resources. This will be difficult unless they are able to pay acceptable rates of interest.⁸³

Thus subsidies will eventually skew the market in a wrong direction. This coupled with the scarcity of capital increased the undesirability of subsidizing SMEs, or any one else for that matter. At any rate, since SMEs are more expensive to lend to on commercial basis, even unsubsidized loans are deemed to have hidden subsidies in them.⁸⁴ This does not bode well for a development strategy found on the possibility of SMEs in generating employment and contributing to meaningful growth. Finance, which is the greatest hindrance for SMEs, is treated neither quantitatively nor qualitatively. The Bank aims at increasing the channels and scope of financing for SMEs, however, in such a fashion so as to limit the real distribution of these resources to a fraction of existing SMEs. The questions multiply: would not this capital be more productive elsewhere? If lending to SMEs is such an unprofitable proposition, why would the market undertake it? And how can a country increase employment and eventually build a development policy based on this sector?

In fact, the Bank itself began to question its assumptions about SMEs and employment. In 1996, the Bank released a review study of the principles and goals outlined in the 1978 report and the action the Bank had undertaken since then. From the period between 1978 and 1993, the Bank financed \$11.5 bln worth of projects that specifically targeted SMEs around the world.⁸⁵ Not a small amount especially considering the credit crunch during the 1980s. The lending was promoted because of the anticipatory benefits of SMEs in generating employment and easing poverty. The Bank's main attraction to SMEs had remained the capital-intensive nature of these industries requiring more intensive use of labor. To the extent that the programs were successful

⁸³ The World Bank Employment and Development of Small Enterprises P 44.

⁸⁴ Ibid.

in promoting SMEs, the resulting job growth would contribute positively to the national income and be distributed more equitably. Furthermore, the benefits of SMEs, as seedbeds for entrepreneurship and market development and flexibility would make them important actors within the circle of developing capital.⁸⁶ The Bank had calculated that these objectives would be met once the Bank had addressed the most important hurdles facing SMEs: these were, institution building, job creation and increasing SME's access to finance.⁸⁷

Institution building proved difficult. Non-market mechanism and inefficiencies within the developing world resulted in the Bank following a more market-based approach to dealing with SMEs issues. This approach was used also in dealing with job creation and with finance. The institutional problem permeated the other two objectives of the Bank, especially finance. Special financing banks and government institutions, mixed with bureaucratization, underdeveloped branch structures, and weak management have resulted in an almost universal failure to achieve the Bank's stated goals simultaneously.⁸⁸ The major problem lay with the mechanism of delivery, and not the theory behind it. The solutions advocated by the Bank this time were not drastically different from those outlined in the 1978 report, however, they were more precise and explicit. Within the emerging dominant discourse, two camps have formed in the Bank, the radicals and moderates. These terms are misleading since the difference in priorities between the two is not significant, but it is worthwhile noting that at least, there is a difference. The radical camp takes a dim view of SMEs as either job creators or potential or potential seedbeds for entrepreneurs. They hold the view that even if SMEs were job creators and seedbeds for entrepreneurs, targeting them specifically is an inefficient method of furthering

⁸⁵ Leila M Webster, Randall Riopelle and Anne-Marie Chidzero World Bank Lending for Small Enterprises 1989-1993 Washington D. C. The World Bank. 1996. P 18.

⁸⁶ Ibid. P 33-34.

⁸⁷ Ibid. P 30.

⁸⁸ Ibid. P 32.

their growth. Instead, the more efficient strategy centers around fostering stable macro economic policies and clearing away institutional biases against SMEs. These reformers advocate:

- i) Simplifying the tax codes and entry and exit mechanism, i.e., less regulation and proper property rights and bankruptcy procedures.
- ii) Liberalizing and streamlining exports and imports to lower barriers for new participants.
- iii) Privatizing state owned enterprises and regulating monopolies.
- iv) Reforming bank regulation to promote competition.
- v) Freeing interest rates.
- vi) Reforming property laws.
- vii) Reforming labor laws.⁸⁹

Those familiar with structural adjustment programs (SAPs), would immediately recognize the similarities and universality of these requirements. This analysis of SMEs in effect denies the special nature of these enterprises and restricts them to the general treatment of the market. Previous SME theorists have claimed a sense of universal uniqueness associated with SMEs. The radical camp in the World Bank would deny these institutions such a privileged position.

The second camp, the moderates, do not disagree with the first regarding the importance of structural adjustment. However, this group believes that some form of special policies are needed to help offset the negative affects of these policies, especially on SMEs.⁹⁰ The end result for having both groups sharing similar ideas, and the bank pursuing a strategy of structural adjustment and liberalization, has been a reduction of the amount of financing the Bank extends specifically to SMEs. These reductions in loans have not always come as a result of failure, even

⁸⁹ Leila M Webster, Randall Riopelle and Anne-Marie Chidzero World Bank Lending for Small Enterprises 1989-1993 P 34.

⁹⁰ Ibid. P 35.

in the Bank's own analysis of projects, but many projects have been cancelled "because they had become inconsistent with prevailing ideology."⁹¹ The Bank's emphasis has been directed towards the sustainability of its programs. This means that programs are successful if they show an ability to sustain themselves and to have a long-term effect on the area they were implemented in. Most of the time, sustainability has been reduced to profitability. Programs were to become sustainable by becoming profitable. The transaction cost of lending should be lowered. These are lowered by utilizing some of the remedies advocated by SAPs policies. Thus, increasing competition among banks, reducing excessive bureaucracy, inefficient administration are all steps that be taken to lower costs. The second step in lowering administration costs is achieving high repayment rates. Government owned banks and institutions have been poor performers in this regard, thus Bank funding has been re-directed to private channels and private banks. Reducing risk is the third element of this strategy and it slightly contradicts the other two because this is based on loan guarantees that tend to suffer from under capitalization. The last and most successful bank achievement is appropriate pricing, or getting prices right. The Bank has been successful in persuading government to abandon price subsidies in favor of commercial rates. These rates should not be fixed either as flexibility to market adjustments demands the existence of a floating interest rate policies, even for SMEs.⁹²

However, despite the Bank's success in introducing market mechanism into developing countries, it has been disappointed by the effectiveness of its SME program to such a degree that by 1991, specific SME lending had ceased all together. Instead, the Bank included SME provisions in wider loan portfolios. The Bank however resumed lending through the International Finance Corporation as of 1996. The IFC undertook 118 specific projects between

⁹¹ Ibid.

⁹² Ibid. P 35-37.

1996 and 2002, but with limited funding.⁹³ The Bank itself resumed lending in 1997, however, the IFC assumed the bulk of the loans administered. The combined amount lent since 1997 has been around \$10 bln in loans designed specifically for SMEs.⁹⁴

Interestingly enough, as the Bank was stopping financial assistance designed solely for SMEs, another Bank study published in 1995, was reciting the successful nature of the Bank's inspired projects towards SMEs. The study looked specifically at African countries, the region that had the worst performance indicators in the Bank's analysis of SME projects. Since the study was not comparative, it did not really challenge the conclusions of the Bank. However, the study did represent the views of the more moderate officials within the Bank. The study opens with a list detailing the importance of SMEs to economic activity in general and to Africa in particular. The report has a more hopeful outlook regarding SMEs: "the basic thesis is that MSE (medium and small enterprises) can provide an avenue for both transforming the economic structure to support growth and engendering the participation of diverse segments of the population."⁹⁵ This article reiterates the general benefits associated with SMEs, including jobs and entrepreneurship, and adding two contemporary topics, women and the environment. The study however spends little time analyzing the effects of bank policies on either of these new groups. What is interesting is that in reaffirming the general benefits of SMEs, the authors of this report take a semi-historical outlook that views SMEs as a viable development mechanism. SMEs are important because of 3 things:

- 1) Dynamic progression: this is the semi-historical aspect of the report. SMEs are tied directly to the industrial transformation of early industrial countries. In a system

⁹³ International Finance Corporation Project Documents Search Results.

<http://wb1n0018.worldbank.org/IFCExt/spiwebsite1.nsf/Results09072002115718PM?OpenView&Start=88>

⁹⁴ The World Bank World Bank Group Review of Small Business Activities 2001.

http://www.ifc.org/sme/acrobat/sme_annual_2001.pdf P 10.

⁹⁵ Ronald L Parker, Randall Riopelle and William F. Steel Small Enterprises Adjusting to Liberalization in Five African Countries. Washington D. C. The World Bank. P 12.

reminiscent of Rostow, the comparison is again made between England and African developing countries. This section is essentially the possibility of SMEs. One day, SMEs will become something else, preferably, according to the report's authors, large enterprises.

- 2) Innate characteristics: this is the general list of SME benefits in general and to developing countries in particular. Here we find the usual list of flexibility, low start up cost, proximity to markets, broader distribution of income, and facilitation of women's entry into the work force.
- 3) Artificial repression: this is the promise of SMEs. If the first feature was the possibility of SMEs, this section represents promise of these entities. Restrictive policies and regulatory measures have dampened the productive potential of SMEs. SAPs have begun the process of institutional reform needed to address these problems. But this process requires time. The implementation of SAPs and changing the macroeconomic situation are the first steps in the institutional change needed so badly according to the previous and current reports. These macroeconomic changes, which include liberalization and privatization of the economy, are the most important ingredients to help start up companies enter the market and flourish. Some still need assistance, but this need not only be monetary.⁹⁶

Institutional support such as that outlined earlier is advocated. However, the positive effects of SAPs on productivity, increased competition and reducing entry barriers are more fundamental than training and finance. We will not diverge to discuss the effects of SAPs on productivity and employment, a topic which has been researched effectively elsewhere. What we aim to point out here in this short analysis is the opposing messages that come from the Bank regarding SMEs.

⁹⁶ Ibid. P 15.

The report sees great potential for SMEs as a development strategy. The other report indicated a near total failure in this regard. Both reports advocate almost identical policies. They both share the concern regarding the importance of market driven policies and tying the possibility of good results to further implementations of these policies. The grim picture painted by the first report seems to dominate the Bank's approach towards SMEs. Funding has resumed under the auspices of the IFC and departments with the UN such as UNIDO and even the IMF. In none of these new loans are SMEs promoted as a genuine development vehicle. SMEs are promoted as job creators, as poverty reducers, and even as potential hotbeds for entrepreneurs. However, policies on the ground and the Bank's own macroeconomic vision relegate SMEs to secondary development arenas. The benefit of SMEs lies in the fact that they are conducive to reiterate the Bank's vision regarding private/public interactions and the role of the market in societies. SMEs can become better institutions when market relations prevail. Since the Bank is a major source of development money and ideas, it is perhaps helpful to escape the confines of the bank to take a look at how some developing nations deal, and have dealt with their SMEs. The following section will look at the role of SMEs in 4 developing economies: Lebanon, Egypt, S. Korea and Taiwan, in order to determine whether the Bank's policy is followed universally or not. The essay will specifically look at how these countries have attempted to finance their SMEs and to what effect and for what reason.

Specific Funding Mechanisms for Developing SMEs.

This section will look at 4 different cases: Lebanon, Egypt, South Korea and Taiwan. These cases will give examples of SME financial policies that depend on Banks, such as the case in Lebanon (market determined), on sustainability, such as the case in Egypt (partial subsidies) and on multi-layered support strategy. The cases will illustrate that getting prices right is akin to

excluding the SME sector from economic activity, contrary to what the Bank predicts.

Sustainability also has become to mean profitability which means the impoverishment of SME support structures. The multi-layered approach exemplified by S. Korea and Taiwan shares some similarities with the Bank's emphasis on sustainability but is in direct opposition to getting prices right. S. Korea and Taiwan will illustrate that getting the prices right is not an option if the desire is to support or save the SME structure, especially in times of crisis. To genuinely support SMEs, multi-layered approach is needed.

Lebanon:

Lebanon in many ways is a special country. It was for a long time seen as a potential hub of business in the Middle East; the 17 year long civil war dashed these hopes. However, the highly liberalized Lebanese economy, after the war, has failed to recapture some of the vigor it had in the late 1960s and early 1970s. Like many other countries, Lebanon has a large SME sector that fails to approach the size mentioned often in Western, or even, East Asian literature regarding SMEs. In Lebanon, SMEs are identified as those enterprises employing 5-20 workers and comprise 97% of all economic entities. However, SMEs employing 10 workers or less account for 95.2% of all enterprises in the country. Of that percentage, 73.7% employ less than 5 workers. Nevertheless, these enterprises provide 67% of total employment in the country. Medium enterprises, employing 10 to 50 workers comprise 4.2% of Lebanon's industrial companies. Between 1995 and 2000 50.4% of all Medium sized enterprises have been forced out of business. The period between 95 and 2000 is seen as the cool off period following the reconstruction effort after the war.⁹⁷ The net effect of a stable macro economic situation has meant the virtual starvation of the sector for fresh credit. As a result, the government in Lebanon has attempted to establish a credit guarantee fund to help local SMEs. However, following a

liberal model (requiring little financial commitment from the government), the government's efforts have not been able to affect the situation dramatically. The government, in conjunction with the central bank, set up a credit guarantee company in 1997 to ease the financial situation for local SMEs. Societe Kafalat operates in a market mechanism but with recourse to subsidized loans. The hope in the country was that banks would start normal operations in regards SMEs and furnish needed finance. This however has not been the case. As an example, the bank of Byblos, the largest and most successful bank in the country, only opened an SME division in 1999. Between 1999 and 2000, the Bank of Byblos lent 10 million US dollars in loans to SMEs.⁹⁸ The conditions for applying are straightforward and non restrictive, however, the cost of the loan, and the cost of the lack in collateral make the loans inaccessible to most local SMEs. The conditions include the applicant being 18 years of age or more, two years of relevant experience in the concerned industry, and a proof of income statement either through past records, banks transaction statement showing the activity of the last six months or receipts from suppliers. The size of the loan ranges from a minimum \$5000 to a maximum of \$50,000. This amount can be a straightforward loan or an overdraft facility. Such a facility covers operations dealing with trade, or can act as an emergency facility to cover cash shortfalls. However, the interest rate on these loans are punishing, making the large loans effectively available only for trade or short term purpose where the sum can be repaid without incurring large interest charges. Industrialists are less likely to find these loans economically feasible at the present interest rate. This is so despite the existence of a special capital investment purpose for the SME loans. The interest rate on these loans range from a low of 14.75% to a maximum rate of 18%. The lower rate is awarded to loans denominated in US dollars whereas the higher interest is awarded for

⁹⁷ Republic of Lebanon - Ministry of Industry in cooperation with GTZ (German Technical Cooperation) Industrial Strategy Report: Findings and Analysis. 2000. P 33-35.

loans taken out in Lebanese pounds. Such rates are tied directly to the macro economic situation of the country and the emphasis the government places on stable currency, low inflation and on maintaining a cozy relationship with creditors. To pursue its goals, the government has maintained a high interest rate policy. The rate has actually gone down substantially from its previous highs but remains punishingly high for small investors. Byblos bank's SME rates are based on an additional fee imposed on what the government awards in interest on central bank treasury bills denominated either in Lebanese pounds or in US dollars. The interest rates awarded by Byblos bank are dependant on the kind of collateral that is offered. Although collateral is not required, its availability affects the cost of the loan. If the collateral guarantee is equal to the size of the loan and ownership is transferable to the bank, then the rate on US loans is 14.75%, and on a Lebanese loan is 16%. If however the guarantee is not 100% backed, such as a promise of no use, or a third guarantee, then the rate increases to either 16.75% US or 18% LL. In addition, there is also a 2% semester commission on the loan. Assuming two semesters per year, then the real interest rate increases by 4%.⁹⁹ Thus, the minimum yearly rate is 18.75% on US\$ and 20% on LL and a maximum of 20.75% or 22% annually. As has been mentioned, such rates are beyond the means of most local SMEs. Thus the loan ratio remains very low in comparison to the actual number of SMEs operating in the country. Kafalat, the credit guarantee company was supposed to remedy that. Since its inception in 1997, Kafalat has facilitated loans to 1010 enterprises for loans totaling 66.33 Million US\$.¹⁰⁰ Again, helpful numbers but falling far beyond the needed amounts. Kafalat subsidizes the Bank's rates and guarantees a large portion of the loan for the bank. Thus, the normal rate of lending for industrial SMEs is discounted to an affective rate of 3%, a very reasonable and affordable rate. However, lack of

⁹⁸ From an interview conducted with Mss. Josephine Bassil, head of the SME department for the Bank of Byblos, by Makram Malaeb on November 16, 2000

capital and a serious depression of productive and agricultural economic activity in the country have meant that one-tourist operations and service companies are in a position to apply for loans. Thus most of the hubs of industrial activity, grouped in small-scale production industrial areas, are left out of the financial scheme. Furthermore, the prices for production inputs in Lebanon, such as electricity, fuel, and raw materials is prohibitive. The sector continues to suffer as Lebanon continues to experience low growth rates and the budget is fully consumed in debt repayments. SMEs in Lebanon are, much like elsewhere, the backbone of the economy, but not the leading contributors in terms of production. Despite accounting for 97% of enterprises, SMEs actually only supply 67% of employment. The potential for growth is there, however, the strategy to push these organizations forward has thus far been inadequate. The liberal trading regime in Lebanon has not been an obstacle to entry for SMEs, a finding shared by the African SME study as well. The need for financing however is clear. The numbers of enterprises receiving specialized SME loans, or any other loans is small. The program sponsored by the government thus far has not produced marked results.

Egypt:

The situation in Egypt is similar to Lebanon; however, the scale of the problem might be even more acute. The Egyptian government however has more programs directed to SMEs and to micro enterprises than does the Lebanese government. Nominally, SMEs in Egypt account for 90% of total enterprises. Informally, the number is even higher. Some estimates put the number of formal and informal enterprises in the country at 2 million. Officially, SMEs number about 220,000 in the country. In either case, they are numerous. As such, and especially following

⁹⁹ Bank of Byblos Banking For Your Business: Professional and Small Business Loans Beirut, Lebanon. <http://www.byblosbank.com.lb/byblosbk/bfub/professional/middle.htm> 2000.

¹⁰⁰ The Syria Report Loans to SMEs on the Rise <http://www.syria-report.com/LebanonNews24.htm>. Sept 8/2002.

structural adjustment program, the government established the Social development Fund, an organization that is given the task of creating internal economic development and lessening the effects of SAPs on the general population. In 1991, the fund opened a special unit dedicated to SME development. Since its inception, the Enterprise Development Program has assisted more than 46,000 local SMEs, a significant number.¹⁰¹ The program's criteria for lending are not easy and include regular documentation needed for regular loans. The rate of lending is affected by but not completely dependent on the market rate. These rates range from a low of 7% for new enterprises to 13% for existing ones.¹⁰² One of the major aims of the program is sustainability, which means continuous independent financial operations for the program. This is the same language used in the World Bank studies regarding the issue of SME lending. The aim of the Egyptian program is not development based on the SME sector, but a patch up policy aiming at getting most out of the sector for the least amount of money needed. This line of thinking is carried through to Egypt's second SME lending arm: the Egyptian Credit Guarantee Company. The CGC was created in 1989. It is a joint stock company made up of 9 holding banks, with the National Bank of Egypt holding the largest share with 18.19% of total shares.¹⁰³ Interest charged is based on going market rate with an additional 0.5-1% administrative charge added on. Credit worthiness is determined by the banks; if the client has a solid proposal, is credit worthy and fulfilled most of the bank's requirements, but could not offer adequate collateral, the case is then referred to the CGC to obtain credit guarantee.¹⁰⁴ This scheme is more market oriented than the one sponsored by the SDF. The additional administration fee, the stringent conditions of applying, and the guarantee levels of 65-80% of the loan, act as an exclusionary factor against

¹⁰¹ United Nations Conference on Trade and Development Egypt <http://www.unctad.org/med2000/images/Egypt.pdf> P 1.

¹⁰² Government of Egypt Social Fund for Development – Small enterprise Development Organization Sedo Loans <http://www.sedo.org/en/Loans/Index.asp?L1=1>

¹⁰³ Abdel Salam, Ahmad. SME Credit Guarantee Schemes Case study: Credit Guarantee Company in Egypt. 27th Congress ISBC. Seoul, Korea. July 2000. P 5.

most SMEs. Total loans issued by banks because of CGC guarantees up to date were LE 1.6 billion, direct CGC guarantees amounted to LE 0.79 billion. These guarantees enabled 14,512 borrowers to access otherwise inaccessible loans.¹⁰⁵ However, this leaves the majority struggling with either inadequate or overpriced finance. The CGC suffers from a profitability problem. This problem stems from the dubious mandate that is the *raison d'être* for the CGC. The mandate states that the CGC is “to participate in the economic growth of Egypt through the resolution of the acute problem of formal credit access facing SMEs”.¹⁰⁶ This resolution is to be based on private market principles as outlined in the “private Enterprise Credit Project” which is the originating idea for the CGC. The CGC is then entrusted to accomplish a social economic service based on market principles. The problem lies in the contradictory nature of the CGC’s mission. Its mission, as has been stated, is to provide loans for the loan-deprived SME market. However, one of the major obstacles in obtaining loan is high interest rate. Thus, the CGC cannot impose a high interest rate for its services because such a move would limit the extent of benefits obtained from the existence of the CGC. As such, the CGC is forced to keep a very low administrative charge tagged on to its loan. The 1% administrative charge is hardly adequate to pay for the administrative costs of the program which reached LE 2.4 million in 1999. More problematic is the fact that the CGC has been unable to achieve profitability since 1997 where its revenues outpaced its expenses by LE 0.9 million. On a positive note, the CGC has been able to break even in fiscal years 1998 and 1999. Furthermore, its revenues, although equal to expenses in both years, increased from LE 11.5 million to LE 12.5 million.¹⁰⁷ Nevertheless, the inability of the program to sustain a profitable income is a sign of problems. Without adequate

¹⁰⁴ Ibid. P 9.

¹⁰⁵ Ibid. P 14.

¹⁰⁶ Abdel Salam, Ahmad. SME Credit Guarantee Schemes Case study: Credit Guarantee Company in Egypt. P 1.

¹⁰⁷ Ibid. P 14-15.

commitment, these programs remain at best beneficial to a minority and at worst cosmetic in nature.

S. Korea:

The S. Korean government has one of the most state centered economic systems within the capitalist world. The S. Korean model can be accurately termed a state centered developmental model. The role of the state in S. Korea has been declining since the mid 80s. The onset of the Asian crisis in 1997 helped accelerate this change. Nevertheless, S. Korea remains heavily dependent on the role of its government to support and revitalize the economy. Paradoxically, the Asian crisis, which devastated the economy, helped further the cause of S. Korean SMEs as conglomerates collapsed one after the other. The S. Korean government stepped in to revitalize and save the collapsing conglomerates. However, it also increased its attention towards local SMEs due to their importance and vitality for the economy and a desire to restructure the economy away from few family owned businesses.

The S. Korean government set up the Small and Medium Business Administration (SMBA) just prior to the crisis in February of 1996.¹⁰⁸ The SMBA is a state organization responsible for fostering and promoting Korean SMEs. The agency provides SMEs with a multitude of support services such as training, marketing, R&D and help in obtaining several forms of financing. One of the most important aspects of financing services is Credit Guarantees. The SMBA co-ordinates two older credit Guarantee funds for SMEs, which have no way of providing collateral for loans. These are the Korean Credit Guarantee Fund and the Technology Credit Guarantee Fund. The SMBA also provides cover for commercial bills thereby shielding SMEs from the threat of insolvency arising from customer non-payment for services or goods provided.

The role of SMBA for Korean SMEs is significant. Banks provide Korean SMEs with most loans. In 1997, banks provided Korean SMEs with 82.3% of their funding requirements. This figure decreased in 1998 following the Asian crisis but it was an increase over the 1996 figure, which totaled 79% of financing for SME debts.¹⁰⁹ The proportion of funds from non-bank sources and corporate bonds decreased from 11.9% to 8% and from 6.7% to 3% respectively.¹¹⁰ Thus banks play an essential role in financing local SMEs and so does the SMBA. By facilitating access to guarantees for existing and start-up SMEs, the SMBA ensures a continuity of essential credit to Korean SMEs who would not be able to survive without it. The Asian crisis, despite having shifted the attention of the government to SMEs, dealt them a heavy blow. Banks became more and more reluctant to lend money in general and specifically to SMEs with their high debt to equity ratios. As a result, the government stepped in to ensure continued credit to SMEs. The S. Korean Government introduced the “system of Guideline Ratios for SMEs.” This system introduced compulsory lending ratios to commercial banks, local banks, insurance companies and merchant banking corporations. They were to allocate 45%, 60%, 35% and 25%, out of their total loan portfolio to SMEs.¹¹¹ However, due to the Asian crisis, most banks failed to achieve these rates. Even specialty government owned investment banks failed to meet these requirements as they were merged into regional banks in order to consolidate and restructure the financial sector. Thus, the Korean system suffered deeply from the Asian crisis. As a result, S. Korea has been increasing funding for the main credit guarantee agency: the Korean Credit Guarantee Fund (KCGF). The KCGF was established on June 1st, 1976. It guarantees funds for most enterprises but with a special emphasis on strengthening

¹⁰⁸ Small and Medium Business Administration SMBA Forward speech

<http://www.smba.go.kr/english/foreword.html>

¹⁰⁹ Hong, Soon-Yeong, Jang-Hyuk Park, Jong-Young Park. Status and Prospects of Small & Medium Enterprises (SMEs) in Korea Korea Small Business Institute. Seoul, Korea. (SME financing part: section 2.)

<http://www.smba.go.kr/english/sme.htm> June 1999.

¹¹⁰ Ibid.

credit support for SMEs. Funding for KCGF comes mostly from government sources according to budget priorities.¹¹² However, banks are required by law to contribute 0.2% of the total amount of their loans in certain categories to the fund. The KCGF guaranteed 9,534 billion won in 1998. By 1999, this figure has been increased to 10,483 billion Won (\$8.75 bln).¹¹³ This is despite the fact that S. Korea was and is still suffering from a deep financial crisis. The maximum ceiling on a KCGF guarantee is 3 billion Won, thus, effectively limiting lending to SMEs since large conglomerates are in need of much higher loan figures. In order to increase the benefits of lending and at the same time reduce the threat of loss, the KCGF established two payment schemes. The first is a fixed payment scheme awarded to loans with collateral. This rate comes to 0.8%/year of the total loan amount. The flexible interest charge is used when no adequate collateral is available. Depending on the loan size and terms of agreement, the flexible charge may vary from a minimum 0.5% to a maximum charge of 2%.¹¹⁴ The KCGF is not the only credit guarantee agency in S. Korea. As has been mentioned earlier, the government also runs a more recent program called Korea Technology Credit Guarantee Fund (KOTEC).

The KOTEC fund was established in 1989 specifically to help foster Korea's development in the technological field. Innovation, especially SME innovation was the main reason for the program. The official aim of KOTEC is to finance promising technology based SMEs, especially, start-up technologically based SMEs.¹¹⁵ Despite its younger status, KOTEC has rapidly grown in size and importance to equal that of its older sibling, the KCGF. KOTEC's capital fund in 1999 was 577 billion Won.¹¹⁶ From its birth in 1989 till 1999, KOTEC received 3,371 billion Won. Furthermore, the importance of the government as a source of finance has

¹¹¹ Ibid. (Section title: Loaning Behavior of Financial Institutions)

¹¹² Korean Credit Guarantee Fund (KCGF) Outline of KCGF http://www.shinbo.co.kr:8084/english/kcgf_main.jsp

¹¹³ Ibid. Credit Guarantee Services http://www.shinbo.co.kr:8084/english/kcgf_what_index.jsp

¹¹⁴ Ibid.

¹¹⁵ Korea Technology credit Guarantee Fund (KOTEC) Brief History <http://www.kotec.or.kr/content8.html>

¹¹⁶ Ibid Outline of KOTEC (capital funds) <http://www.kotec.or.kr/content3.html>

been mitigated with the availability of private finance, that is, until the onset of the Asian crisis. Out of its total capital contribution of 3.3 trillion won, KOTEC received 1.121 trillion from sources other than the government. This is significant since it shows a mostly private orientation to this government owned agency. However, the onset of the Asian crisis quickly reestablished the importance of the government as the major source of funds. In 1999, KOTEC's capital contributions amounted to 577 billion Won. The government furnished 426 billion won out of the total while the rest was divided among the private financial sector.¹¹⁷ The role of private finance will likely grow following financial stabilization. However, the role of the state will remain important since the aim of KOTEC is not profits, but the development of Korean technological capacity through the promotion of SMEs. The role of KOTEC is larger than what its capital base suggests. In 1999, KOTEC guaranteed 11.4 trillion won (\$9.54 US) to more than 48 thousand companies.¹¹⁸ This is a significant number since KOTEC has been in operation for a little more than a decade and is promoting start-ups and technology intensive SMEs.

The results of studying Korea do not lend themselves to easy conclusions. Especially regarding the preference for a government controlled or a privately controlled credit guarantee mechanism for SMEs. The Korean example offers a case of state led support mechanism for SMEs. Despite the Asian crisis, the SMBA, along with the KCGF and KOTEC are very active in promoting SMEs. It is doing so in a number of areas such as training, marketing, internationalization, increasing R&D for SMEs and increasing financing and credit guarantee avenues. The Korean government is not the only one in the region to lend a supporting hand to SMEs.

¹¹⁷ Ibid Financial Statements <http://www.kotec.or.kr/content44.html>

Taiwan:

Taiwan is often studied in conjunction with S. Korea. The two countries experienced exceptional growth rates throughout the 60s and 70s. Both countries shared similar background in being previous Japanese colonies. Similarly, both countries followed a development model similar to the Japanese one where the state engineered growth in the economy. However, Taiwan differed from S. Korea, and from Japan in one crucial factor: the makeup of its economy. Unlike S. Korea and Japan, Taiwan did not discriminate against its SMEs. The Taiwanese political economy came to be dominated not by the conglomerates that dominated its neighboring countries, but by small, family based and owned vibrant enterprises. Today, the Taiwanese economy looks very much similar to the ones surrounding it and to most well developed economies. Such economies are often dominated not by SMEs but by large powerful multinational enterprises. Sales figures in the Taiwanese economy reflect the dominance of large enterprises. In 1999, SMEs accounted for 28.95% of total sales in Taiwan.¹¹⁹ Furthermore, the Taiwanese economy is no more dominated by SMEs than any of its major competitors or advanced economies in general. SMEs account for 97.7% of total business establishments in Taiwan. By contrasts, this figure increases to 99.7% in the US, 99.7% in Japan, and 99.1% in S. Korea.¹²⁰ Paradoxically, Taiwan is viewed as the prototype example of an SME dominated and based economy. How can this contradiction between figures and perceptions be reconciled?

Taiwan is rightly described as an SME dominated economy because of the role SMEs played, and continue to play, in the development of the island, and because of the institutional support which reinforces a highly vibrant SME spawned culture.

¹¹⁸ Ibid Achievements in credit Guarantee <http://www.kotec.or.kr/content333.html>

¹¹⁹ The Republic of China, Ministry of Economic Affairs White paper on the status of SMEs in Taiwan <http://www.moesmea.gov.tw/whitepaper/C-02.htm> chapter 2. P 10. 2000.

¹²⁰ Ibid. p 15.

The first reason has to do with the structure of SMEs within the Taiwanese economy. SMEs in Taiwan have not been barred from involvement in any sector. To the contrary, SMEs in Taiwan have been encouraged to infiltrate every sector of the economy except for the aerospace sector. Strategic industries were considered fair game for SMEs. Furthermore, Taiwanese SMEs have been technology intensive, efficient and flexible producers that were and are still able to deal with the problems of globalization. The point we are making is to emphasize the intangible role of Taiwanese SMEs, which is not captured by pure numbers and figures. But since we are investigating the institutional support provided for SMEs in this project, we will hastily move on and ignore for now the first and very important point.

The institutional make up of Taiwan further reinforces the perception of the country as one built by and for SMEs. SMEs have gained cultural importance in Taiwan and are viewed as a distinct phenomenon giving the island an identity of its own.¹²¹ However, the most unmistakable sign of the importance of SMEs to the make up of the country is the inclusion of an SME protection clause in the constitutional amendment of 1997.¹²²

Taiwan, much like S. Korea, has devoted significant resources to helping SMEs. Unlike S. Korea, Taiwan has always supported SME institutional development and most of its largest programs pre date their S. Korean counterparts. The Small and Medium Enterprise Administration (SMEA), the equivalent of Korea's SMBA was set up in 1981 as opposed to the latter's establishing date of 1996.¹²³ The SMEA performs a regulatory and advisory role similar to the one administered by the S. Korean SMBA. The difference lies in the earlier establishment of the SMEA and in the different programs that it implements. The SMEA co-ordinates the policies of the several SME related agencies to ensure efficient delivery of services. It provides

¹²¹ Small and Medium Enterprise Administration R. O. C's SMEs Ready for the Next Millennium <http://www.moeasmea.gov.tw/home/index.htm>. Taiwan. P 4. 2000.

¹²² Ibid. P 5.

SMEs with technical and advisory support and it has drawn up a ten point SME support and guidance plan that is being heavily promoted. The role of SMEA as a coordinator does not exclude it from the important role of financing SMEs. Early in its career, the SMEA established the “center-Satellite Factory Promotion Program” with allocated capital of NT\$ 10 billion.¹²⁴ The fund aimed at linking and clustering SMEs in competitive structures. By 1989, the fund achieved resounding success by linking 1,186 factories together, mainly, in the electronic industry (Lall, 19). Such project specific funds are not new. Taiwan has several project specific funds that are worthy of further study such as the Small and Medium Enterprise Development Fund established in 1999 with NT\$ 9 billion in earmarked capital.¹²⁵ However, two funds only will be looked at in various details, these are: the SME Development Fund and the SME Credit Guarantee Fund.

As has been mentioned, the SME development Fund was set up in 1999 with a government grant totaling NT\$ 9 billion. This initial capital allowed the fund to immediately enter the business of financing SMEs. By the year 2000, the Fund was providing case specific loans for 6 out of the total 14 possible categories for case specific loans.¹²⁶ Unlike credit guarantee agencies, the Fund hands over the money to SMEs themselves, and not via banks. The fund’s main purpose is also different from most credit guarantee funds. Unlike the former, the fund’s main goal is not to increase liquidity for SMEs but to help pay for very specific structural

¹²³ Small and Medium Enterprise Administration History <http://www.moeasmea.gov.tw/home/index.htm>

¹²⁴ Sanjaya Lall Strengthening SMEs for International Competitiveness For the Egyptian Center for Economic Studies Workshop on What Makes your Firm Internationally Competitive? Cairo. March 6-8, 2000. <http://www.worldbank.org/wbi/mdf/mdf3/papers/firm/Lall.pdf>. P 19.

¹²⁵ Small and Medium Enterprise Administration R. O. C’s SMEs Ready for the Next Millennium <http://www.moeasmea.gov.tw/home/index.htm>. Taiwan. P 13. 2000.

¹²⁶ The Republic of China, Ministry of Economic Affairs Whitepaper on the status of SMEs in Taiwan <http://www.moesmea.gov.tw/whitepaper/C-09.htm> chapter 9. P 08. 2000.

changes those SMEs need to undertake to remain globally viable. These special case loans cover six categories. Loans are given to:¹²⁷

- a) Enhance competitiveness.
- b) For plant relocation in response to government directives to do so.
- c) To cover working capital shortfalls due to economic downturn.
- d) For rebuilding following major natural disasters
- e) For cooperative projects and
- f) For mid or long term exports, foreign investment and overseas construction work.

The fund also gives loans to establish regional SME guidance centers and services. These loans are intended to increase the overall accessibility to services for most local SMEs. Since financing is not the only factor in achieving success and for establishing conducive SME environment, these centers are of great importance. The fund also gives Grants and not loans, but only for companies engaging in innovative R&D. The fund can be looked at as being an intrusion by government into the private sphere. However, this view does not take into consideration the long-standing role that the Taiwanese government has had in promoting SMEs. These programs, such as the ten points system and the SME development Fund, are aimed at improving the structural, institutional and regulative environments. Furthermore, the scale of the operation is not overwhelming. The SME development Fund was allocated only NT\$ 9 Billion for its first year of operations. By contrast, local and foreign Banks in Taiwan provided NT\$ 3,444.3 billion of loans to SMEs in 1999.¹²⁸ Thus, the SME development fund is not so much an incursion by the government into the private sphere but rather, it is a directed effort to remedy

¹²⁷ Small and Medium Enterprise Administration R. O. C's SMEs Ready for the Next Millennium <http://www.moeasmea.gov.tw/home/index.htm>. Taiwan. P 13. 2000.

¹²⁸ The Republic of China, Ministry of Economic Affairs Whitepaper on the status of SMEs in Taiwan <http://www.moesmea.gov.tw/whitepaper/C-04.htm> chapter 4. P 09. 2000.

and provide support for ventures that the market neglects, especially in times of economic downturns.

The other funding mechanism analyzed in this section is the SME Credit Guarantee Fund. This fund shares many characteristics with other SME credit guarantee funds operating around the world. The fund aims at enhancing the ability of SMEs to access much needed finances. The program, like many others, is a joint venture between government and private banks. Banks not only disburse the loans, but provide part of the funding as well. However, the program also faces a major dilemma. This dilemma has been mentioned in the case of the Egyptian credit Guarantee Company. The problem was that the company was given a social/ economical task which was to be fulfilled by using only economical means. However, the economical means used were not market oriented enough to ensure high profit margin and business viability on the one hand while being too market oriented for the social purpose demanded of them on the other. Thus, the Egyptian credit Guarantee Company faced problems in expanding the loan portfolio and in adequately covering operating costs. The Taiwanese SME Credit Guarantee Fund faces the same problem. However, unlike Egypt, the government in Taiwan is taking a more proactive role to remedy the immediate shortcomings of the program.

The SME Credit Guarantee Fund was created on July 9th, 1974.¹²⁹ As was the case with the SMEA, this fund was created before its Korean counterpart. This shows an increased sensitivity by the Taiwanese government to the needs of its local SMEs. Funding for the SME Credit Guarantee Fund comes from federal and provincial governments and from contracted financial institutions. For the year 1999, total donations reached NT\$ 19.958 billion, 83.78% of that amount came from government funding.¹³⁰ Thus, the Banks are very much a minor player in the financing of the fund. The fund however has a very wide reach. It mainly funds SMEs and

¹²⁹ Small and Medium Business Credit Guarantee Fund (SMBCGF) Objectives <http://www.smbcgf.org.tw/english/>

not all companies such as the Korean Fund does. SMEs are those companies with less than NT\$ 80 million in paid in capital with a labor force not exceeding 200 employees. These companies also need a working history of at least three years. Thus, the immediate problem is that the fund does not provide venture capital. But the fund does provide loans on generous terms for local SMEs. For one thing, there is no need for collateral. The only time collateral is needed is when the loan is used to purchase land and equipment, in such a case, the land and equipment themselves become the required collateral. The maximum loan amount given to a single company is NT\$ 100 million, with an annual fee of 0.75%.¹³¹ The negligible annual fee is aimed at providing the fund with enough revenue to cover operating costs. However, the Fund is suffering financially. The fund needs to ensure smooth operations. Thus, it is seeking to improve funding and curb wasteful expenditures. The aim is to target loans better thereby reducing waste and ensuring repayment due to the issuing of financially viable loans. The fund is also looking for donations from companies that have previously benefited from the fund. The hope is such moves will reduce the level of delinquent loans. The number of delinquent loans was high in Taiwan; it averaged 4.41% over the years. However, the ratio rose to 5.97% at the end of 1999.¹³² Such a rise on the rate was not acceptable, but can be partially explained by the earthquake that hit Taiwan and by the continued effect of the Asian crisis. The government seems to tolerate the situation and is willing to provide funding to ensure the continuity of the program. Despite its problems, the program has had a significant influence on the development of financial instruments to Taiwanese SMEs over the years. Between 1974 and 1999, the fund processed 1,786,813 cases. The amount guaranteed as a result were NT\$ 2,144.775 billion. The amount supported is slightly larger than the amount dispersed and comes to NT\$ 2,879.706

¹³⁰ Ibid. Capital

¹³¹ Ibid. Operations

billion (\$1US=\$33 NT) Such amounts are significant and prove the value of the fund for facilitating financing for local SMEs.¹³³ Funding for the program has been actually increased to offset losses and help reduce the expected shortfall in commercial Bank lending for SMEs following the Asian crisis. This is indeed what happened in 1999 with banks decreasing their loan exposure to SMEs by NT\$ 9.1 billion. This is almost the exact amount that the government allocated for the creation of the new SME development Fund. The two events are likely unrelated; however, creating the new fund illustrates the government's willingness to intervene financially in order to relieve some of the pressure off its SMEs.

Thus the small and medium enterprise credit guarantee fund has had a long and fruitful history. Judging by the strides that Taiwan made throughout this period, it can be speculated that the Fund was a positive factor in the island's development. However, the fund is not without its problems. As with SMEs in general, credit guarantee funds seem to share similar problems. This can be perhaps attributed to the dual task demanded of such agencies, the social and economic tasks.

However, experience in countries briefly looked at suggests that there is a desire to include SMEs in the development process not just as shock absorbers but also as active players. The desire does not necessarily turn into practice. In most countries, SMEs occupy a difficult economic position. Their performance lags in many areas as compared with that of large enterprises. Their role in exports, employment, and value added, or any other measure lags as well. The percentages of SMEs as a portion of all other enterprises are overwhelming in every case. This is natural since no economy can support only conglomerates. But their contribution to economic welfare is well below their numbers. This is not to say that they do not play an

¹³²The Republic Of China, Ministry of Economic Affairs White paper on the status of SMEs in Taiwan <http://www.moesmea.gov.tw/whitepaper/C-09.htm> chapter 9. P 7. 2000.

¹³³ Small and Medium Business Credit Guarantee Fund (SMBCGF) Performance

important role. They are without question the backbone of the economy, and since they occupy this position, most governments, especially East Asian ones, have taken great care in supporting SMEs. The theory is any marginal improvement in SME situation would be quickly felt across the economy. However, these states did little more than increase entry mechanism into the economy. Even the liberal Lebanese government is attempting to direct much needed credit to SMEs. It is expedient to re-examine Taiwan since the island is continuously advertised as an SME dominated economy.

With the increasing liberalization of the Taiwanese economy, the role of SMEs should be increasing. The tendency of these organizations to operate without restrictions makes them natural allies of market economics and liberalization. However, the trend has been otherwise. Asia suffered a devastating shock in 1997 and continued through 1998. The Asian crisis seemed to spare Taiwan at the beginning. However, a combination of the lingering effect of the crisis, increased globalization and a devastating earthquake in 1998, have all combined to produce a difficult organizational setting for SMEs. The growth rate of SMEs entering the Taiwanese market amounts to half the growth rate of the number of large enterprises entering the market. This finding is surprising since it is commonly assumed that more SMEs enter the market than large firms. In Taiwan, the growth rate in the numbers of SMEs was 1.49 in 1999, and it was 2.89 for large enterprises.¹³⁴ In parallel development, exports by SMEs declined as well at an alarming rate reaching 21.11% of Taiwanese exports as compared to 26.42% in 1997. This change cannot be attributed to the Asian crisis since large enterprises in Taiwan increased their exports in 1999 by 13.34%.¹³⁵ Thus it seems that in the Taiwanese case, SMEs have not been able to adjust as quickly to internal and external shocks affecting the economy. However, this is

¹³⁴ The Republic Of China, Ministry of Economic Affairs Whitepaper on the status of SMEs in Taiwan <http://www.moesmea.gov.tw/whitepaper/C-02.htm> chapter 2. P 1.

¹³⁵ Ibid. P 11.

not to deny the importance of SMEs in the Taiwanese economy. Their ability to export, invest abroad, and maintain 78% of employment in Taiwan is striking.¹³⁶ In fact, Taiwan still has some of the largest employment figures of SMEs anywhere in the world. Just as a quick comparison, the US, where SMEs account for 99.7% of enterprises in the country, actually employ around 53% of the working population.¹³⁷ In some sense, the Taiwanese case validates the potential employment benefit associated with SMEs. Furthermore, the ability of Taiwan to suffer less compared to the other countries in the region is still being attributed somewhat to SMEs. This might be the case but it seems that it is so because SMEs have worked as a buffer for larger enterprises to cushion the fall.

SMEs in Taiwan are also legally unique, in addition to being protected in the constitution, they are often affiliated with trading companies that can have many members. Thus, within such a setting, they achieve something close to an economy of scale. Mitigating against these external shocks are Taiwan's numerous support agencies for SMEs. Thus in order to have a viable SME sector that is involved in the world economy, Taiwan has had to create multiple support structures that act in accordance with more than ten specialized SME banks and a flourishing curb market that is willing to lend money to SMEs in times of credit crunches. Thus freeing these organization from excessive managerial and accounting demands, working almost in opposite direction to the Business behavior models advocated by the World Bank and other development organizations.

South Korea, the country most associated with heavy government led industrialization, exhibits strange tendencies regarding SMEs. Unlike Taiwan, there is no special cultural or constitutional status for SMEs. But the government has been paying special attention to them

¹³⁶ The Republic Of China, Ministry of Economic Affairs Whitepaper on the status of SMEs in Taiwan chapter 2. P 16.

¹³⁷ Ibid.

since the 80s. This has only intensified following the Asian crisis. At first glance, S. Korea also exhibits an argument in favor of large enterprises despite the economic disaster of 1997. Growth rates for total assets, productivity and wages all favored large enterprises. In 1997, total assets for large enterprises grew at a rate of 15% compared to 4.2% for SMEs.¹³⁸ The conclusion to be drawn is that large enterprises generate more economic activity in general than SMEs. To back this statement up, productivity levels for large enterprises also surpassed those achieved by SMEs. Productivity levels for large enterprises increased by 11% in 1997, while SME's productivity growth rates remained at 38.4% of those experienced by large enterprises.¹³⁹ The trend repeats itself in wages where the average wage per employee in large firms was 21mn won, while SME wages averaged at around 13mn won per employee.¹⁴⁰ The trend is that in most indicators regarding to productivity and unit cost, large firms employing economies of scale tends to achieve better results than SMEs. However, SMEs do exhibit competitive tendencies. Korean SMEs experienced continuous growth in their contribution to gross output of manufacturing. In the 1980s, SMEs accounted for 47% of gross output compared to levels ranging between 25-35% during the 1960s and 1970s. However, SMEs have so far failed to break the 50% mark as large firms continued to dominate the manufacturing sector.¹⁴¹ SMEs were competitive in other areas vis-à-vis large firms. Average growth rates for the number of SMEs have increased throughout the 90s. SMEs experienced a 5.1% increase in their numbers between 1990 and 1997 while large firms decreased by 6% during the same period.¹⁴² In a parallel fashion, the share of SMEs in job creation, especially in manufacturing, has continued to

¹³⁸ Hong, Soon-Yeong, Jang-Hyuk Park, Jong-Young Park. Status and Prospects of Small & Medium Enterprises (SMEs) in Korea Korea Small Business Institute. Seoul, Korea. (SME financing part: section 2.) <http://www.smba.go.kr/english/sme.htm> June 1999. P 26.

¹³⁹ Hong, Soon-Yeong, Jang-Hyuk Park, Jong-Young Park. Status and Prospects of Small & Medium Enterprises (SMEs) in Korea P 24.

¹⁴⁰ Ibid.

¹⁴¹ Ibid. P 9.

¹⁴² Ibid. P12.

increase. During 1991, SMEs accounted for 63.5% of all jobs in manufacturing, by 1997, their share had increased to 69.3% while that of large firms had dropped to 30.7% from 36.5% earlier.¹⁴³ These figures indicate the Korean SMEs did a little better than large firms in responding to the Asian crisis. On the employment front, SMEs continued to increase their share of the labor force and their numbers have also increased. This shows a growing resilience for Korean SMEs and shows the growing maturity of the Korean market place. SMEs are no longer the mom and pop shops struggling to keep going. They are, with some validation to SME theory, almost ready partners that are beginning to be taken seriously by the chaebols as possible junior partners in their economic activities. Korean SMEs are active players in the internal and external markets of the country. As indicated above, they contribute approximately 47% of total output within Korea, they also account for 42.8% of exports, as opposed to Taiwan's 21.11%. However, success did not come about unaided. The Korean government has indicated in the 1980's, that it wished for SMEs to handle 40% of all Korean exports. To this goal, the government has dedicated numerous specialized agencies to help finance and train SMEs. In Korea, as in Taiwan, the banks provide the bulk of the funding for SMEs. This is generally regarded as a good sign since the banks are conservative in nature and tend to be less willing to finance SMEs. In Korea, the banks are responsible for high portion of financing, amounting to 82% in 1997.¹⁴⁴ This amounted to 46,494 bln won in 1997. In 2002 figures, this amounts to \$38.91 bln. Since exact figures are not available, we will attempt to put in perspective the importance of the government in generating and guaranteeing these funding levels. During 1999, the Korean government, through the KCGF and KOTEC, the government either directly guaranteed or directly financed 21,883 bln won for SMEs. This amounted to \$18.31 bln,

¹⁴³ Ibid. P 15.

¹⁴⁴ Hong, Soon-Yeong, Jang-Hyuk Park, Jong-Young Park. Status and Prospects of Small & Medium Enterprises (SMEs) in Korea P 49.

roughly, 47% of funding generated to SMEs through the market. The assumption that the government causes inefficiencies is wide spread. However, without the help of the government, Korean SMEs, which were failing at a rate of 120 to 140 units on a daily basis, following the introduction of the IMF austerity program would have devastated the sector, making it viable only for employment generation and low level economic activity.¹⁴⁵ S. Korea has long made a strategic decision regarding its economy. The government will not sit ideally by if the economy is in crisis. It has taken many years and crises to loosen the grip of the government on the economy, but it has not separated the two spheres. Both Asian tigers have liberalized their economies significantly, and both pay heed to the language of internationalization and liberalization of economic affairs. However, neither is ready to neglect their economic development. Both countries contribute significant resource for the promotion of their SMEs and of their other industrial units. The aim is to keep competitive with the world by producing competitive enterprises. Both countries have gone far in the liberalization process and their policies have ceased to resemble those policies they enjoyed even in the 1980s, let alone the 1970s or late 1960s. The victims of such liberalization are the same, labor, women and the poor. Both countries value the role of SMEs as potential solution to some of the economic problems of liberalization, but both are willing to invest heavily in this potential. Both governments have in fact a strategy of supporting SME growth and not letting the market alone decide their fate. In the conclusion of the exhaustive report on Korean SME, the others do establish a strategy, laden with free market discourse, on how SMEs are to be helped. They are to be helped in the

- i) Technology and quality competitiveness sector. Massive government, university sponsored research undertaking aimed at identifying competitive SMEs and helping them develop their products.

¹⁴⁵ Ibid. P 4.

- ii) Export capabilities: aims at increasing SME share in exports to 50%.
- iii) Support for start-ups and venture enterprises: the riskiest side of SMEs, these organization lack funding. Government lab funding is to be substantially increased.
- iv) Support to stabilize SME management.
- v) Support for small companies and provincial SMEs; to help distribute the benefits of growth away from the Seoul district.
- vi) Improvement of SME support systems and institutions.¹⁴⁶

This extensive program is a far cry from asking SMEs to accept market rates for their operation except in the case that the funding is there to help the poor. The difference between the two visions is one of functionality and potential. The WB vision sees the potential of SMEs only in rhetoric, and in ways that promote the ideology of SAPs and of “good governance” and Business culture. The vision in East Asia is more entrenched in the possibility of development. It is fueled with the desire to remain economically viable entities.

Lessons from SME funding mechanisms:

The previous section looked at 4 cases: Lebanon, Egypt, S. Korea and Taiwan. The main lesson to be learned from the cases is that getting the prices right, as the Bank advocates, is not enough. In many respect, it is not even helpful. The case that resembles most a strategy of getting the prices right is Lebanon. The government prides itself on its liberal inclinations:

Lebanon has a long tradition of domestic free trade and investment policies, with free market pricing for most goods and services, an unrestricted exchange and trade system and extensive links with the developed world in practically all economic activities. The Government has maintained a generally non-interventionist stance toward private investment, and public ownership has generally been limited to infrastructure and utilities. There are no restrictions on the movement of capital and goods by residents and non-residents of the Republic, including on entry or exit of firms or on access to foreign exchange, which makes Lebanon a supportive system for private sector development.¹⁴⁷

¹⁴⁶ Ibid. P 80-85.

¹⁴⁷ Ministry of Finance – Lebanon Country Profile – The Economy <http://www.finance.gov.lb/> P 9.

In addition, the IFC is very active in Lebanon being directly responsible for \$336 million of direct lending to the country and an additional \$256 million raised through loan participation.¹⁴⁸ Thus the country and the WB and its institutions are heavily involved in the reconstruction of the country. However, the economy has faltered in recent years, as inflation was brought under control, the GDP and the budget took a negative turn. Since 1996, exports from the country dropped from \$919 million to \$889 million in 2001. At the same time, the GDP increased in size from \$12,996 Bln to \$16,708 in 2001 with most of the growth occurring between 1996 and 1998.¹⁴⁹ This means that effectively, the percentage of exports for the Lebanese economy as a whole has been shrinking. As exports were decreasing, the SME sector was hard hit, losing, as has been mentioned, about half of its industrial firms by the year 2000. The liberal stand that the government has insisted upon since the end of the civil war in 1991 has not helped these enterprises. The same stand that the government continues to follow has delivered precious little to SMEs since the economy is expected to falter for another year. Thus operating under the guidance of market principle to deliver services to SMEs in the hope of helping the economy as a whole has failed within the SME sector and within the general economy as well. The government's insistence on adhering to market principles is one sided since it has intervened extensively to "get prices right" by lowering inflation and custom duties, and thus substantially increase the debt through high interest rates, but has done very little to support the productive sectors of the Lebanese economy. The previous section that looked at private bank lending and the role of the government credit guarantee fund (Kafalat), has demonstrated that market-oriented principles excluded most SMEs from participation. Any strategy built on helping SMEs help the general economy is thus doomed to failure because SMEs cannot be helped by pure market mechanisms. The market in Lebanon as a whole needs help. This point is crucial, in

¹⁴⁸ Ibid. P 15.

times of economic adversity, the market often fails to generate sufficient economic activity to quickly generate wide spread economic benefit. Thus the market in Lebanon itself is in dire straits and cannot be dependent upon to salvage the economy as a whole.

The Egyptian case resembles the Lebanese case in that it follows one of the WB's important buzzwords, sustainability. This word (translated into profit) which is another version of getting prices right, is inadequate to achieve important economic goals such as the rehabilitation of an entire sector of the economy which suffers from serious neglect. The SDF program is under-funded and charges relatively speaking high interest rates while the CGC's low interest charges limits its reach, increases the costs to borrowers and is not sufficient to make the program sustainable. The talk about sustainability (profit) has rendered these specific programs semi private arrangements. The duality in their nature is a cause of concern since neither mandate (the social or the economical) is being fulfilled under the auspices of sustainability. If there is an SME support strategy, the main goal should be to help these organizations become economically viable then charge them rates. In any case, their supposed contribution to the economy in generating extra income and employment, among their many benefits, should be more than adequate to justify the costs of running the programs.

The South Korean and Taiwanese cases are both indications of what sort of commitment is needed to achieve a semi-viable SME sector within the economy. The S. Korean government has had a long history in developing its economy. The strategy that the government used, inspired by Japan, has been dubbed development by learning. This means that development occurs not because of inventing new things, or innovating what has already been invented, but by developing a structure able to accumulate the technical skills required to undertake accelerated economic activity through using already available resources. An abundant, low wage, highly

¹⁴⁹Ministry of Finance – Lebanon Country Profile – The Economy P 9-12.

educated labor force is the engine of growth in this strategy.¹⁵⁰ In order for this labor force to use the fruits of modern technology effectively, the state had to intervene to create the labor force, import needed technology, and generate an ability to copy and improve what has been already created elsewhere. This strategy, in an opposite fashion to the WB's emphasis on getting prices right, in fact acted deliberately to set prices wrong to create investment opportunities.¹⁵¹ Even in today's liberal environment, the creation of KOTEC, as an intensive technology funding mechanism, is reminiscent of the government's direct intervention to create competitive industries within the Korean economy, such as the chemical industry in the 1970s.¹⁵² The example of government involvement in guaranteeing finance for SMEs at favorable terms contrast with the experience presented by Lebanon and Egypt, and by the general thrust of advice presented by the WB and its sister organizations. S. Korea, in fact, is the only country studied that is following a policy of developing SMEs. Taiwan generously supports its SMEs but only S. Korea has made it a goal to change the export structure so that SMEs are responsible for 50% of total exports. Taiwan has made no such commitments. The S. Korean example, despite lip service to market buzzwords, is in fact again engaged in distorting market prices to achieve a specific goal. The government's involvement in facilitating finance, and providing extensive financing for technology intensive SMEs, even in form of grants, is in direct opposition to sustainability and business like attitude as is understood by the WB.

The Taiwanese government also supports its SMEs generously and actively engages in the creation of innovation opportunities. The government's involvement in acquisition of

¹⁵⁰ Alice H. Amsden Asia's next Giant New York. Oxford University Press. 1989. P 18.

¹⁵¹ Ibid. P 14.

¹⁵² Joseph J Stern, Ji-Bong Kim, Dwight H. Perkins and Jung-ho Yoo Industrialization and the state: The Korean Heavy and Chemical Industry Drive Harvard University Press. USA. 1995. P 59.

foreign technology has been an integral part of the island's development strategy.¹⁵³ And as has been mentioned above, the country has devoted significant assets to the promotion of its SMEs.

SME's in Development Discourse

A quick look at the theory of SMEs and their role in development creates a schism between theory and practice, between promises and delivery. This dichotomy in SMEs is a historical phenomenon. Perhaps the most insightful finding regarding SMEs is their dual nature. They are at once unique and universal, powerful and weak. At times, they are lauded as the model of pure capitalism yet in practice, they get treated as second-class citizens. As an image, SMEs capture the imagination and fit well buzzwords such as innovation and empowerment. The language surrounding SMEs has played a multi-layered role. On one hand, SMEs are regarded as viable economic institutions within development. This vision is propagated on two fronts, the practices of the World Bank and development institutions, and the practice of national development agencies. The Bank and its subsidiaries and partners propose that the viability in SMEs lie in their ability to thrive with low levels of capital investment if the obstacles to their participation are reduced. More economic stability, reform of the tax system, privatization and liberalization are all advocated in order to reduce barriers of entry for SMEs. The convergence between SAPs, poverty reduction strategies, and SME building plans is striking. They all seem to require the same set of policies to be successful. Thus despite lip service to SMEs and to their potential in innovation and entrepreneurship, and despite the fact that the WB, the IMF, UNIDO and most countries, have agencies dedicated to servicing SMEs, there is little that can be pointed to as forming an integrated SME led development strategy. The WB's pronouncement in 1978 to this effect was soon forgotten. SMEs, for the WB, are at best an instrument to reduce poverty or an instrument to create employment at low costs. By 1993, as has been documented, the WB

¹⁵³ Denis Fred Simon Taiwan's strategy for creating competitive advantage In N. T. Wang "Taiwan's Enterprises in

has given up on both assumptions in practice yet continued to pay lip service along these lines. From the start, the WB strategy was based on macroeconomic adjustment aimed to liberalize economies. SMEs were there to give support to the liberalization movement. The struggle was never really between the theoretical arguments between small scale and large-scale production units, but between economic policies based on planning or markets. The initial thrust of development theory in industrialization and planning has been replaced by liberalization and market rationality. The difference lies in that whereas planning was explicitly tied to industrialization and scientific rationality, market policies are self-referential. Everything else is residual and not central, the central issue of market theory is the philosophy governing the distribution of resources. Both poverty and SMEs serve to lend credence to market principles, while neither being tied to it in any fundamental sense. Market economics does not need SME theory to survive, but SME theory seem to be doomed to failure unless based on market principles, or so the WB would argue. The positives effects of SMEs, specifically, innovation, is addressed only as a secondary trait of SMEs in the regions where the Bank is active. Thus SMEs become another mechanism of measurements used to support the rationale behind the Bank's general policies. Such was the case in the Bank's review of specific African countries. An amusing finding in that report was that most SMEs polled never identified entry and exit issues into the market as major concern for them. The Bank, of course, has based its policies on the assumption that the best method of helping SMEs is to redress policy biases against them and allow them to enter the market freely. The finding was used as an indication that more work in training and management is needed so that SMEs could begin to realize how important entry and exit issues really are. This perverted logic is not the exclusive domain of the Bank but has spread to other institutions within the UN as well. Thus a report prepared by the IMF for

UNIDO's Business Development Services (BDS) shares similar lines of thinking with the Bank. Being a frontline participant in SME services, UNIDO has distinguished between perceived needs of SMEs which are advocated by SMEs themselves, and objective/real/logical needs which are identified by the BDS organizations. Once these needs have been identified, the BDS agencies are to take several steps to improve product delivery (their advice). First, development agencies should deal less and less with government agencies and more with Non Governmental Organizations (NGOs). Moreover, these NGOs must have a business outlook and culture.¹⁵⁴ These NGOs, in turn, should be operating to produce a stable macro economy, a competitive micro economy, global linkages and increased investment in people.¹⁵⁵ The attributes of SMEs associated with liberalization are advocated. Things such as closeness to the market, job creation, and to some extent innovation and a stripped down purely cultural definition of entrepreneurship. The propensity of most SMEs in the developing world to be involved in trade or traditional agriculture lends itself favorably to the liberalization calls of the WB and other development agencies. Unfortunately, in a globalized world, the market is often difficult to define and is often located outside of the developing world. Post-fordist terminology fits the language of SMEs but not the actual operation of these organizations. The claims of flexibility are associated with subcontracting, the actual market for SMEs proper and not micro enterprises, is the large companies engaged in international trade or in large-scale production. The assumptions and benefits of SME production and flexible subcontracting are applicable in an already advanced industrial structure. Even in such states, the percentage of SMEs engaged in successful global activity does not exceed 5% on average.¹⁵⁶ The WB is well aware of this since it does not, except in lip service, and pay any attention to SME's role in economic growth since

¹⁵⁴ Puff Kazuko Business Development Services for SMEs: Preliminary Guidelines for Donor-Funded Interventions <http://www.unido.org/doc/310581.htmls> Document #310581, expires Thursday, October 31, 2002. P 27.

¹⁵⁵ Ibid. P 25.

the strategy for SME development is the same for liberalization. The main purposes of SMEs according to the Bank are poverty reduction and job creation. Even in the field of job creation, SMEs tend to exhibit opposing tendencies. Throughout much of the Western world, SMEs accounted for most of the jobs created since the early 1980s. This is in contrast to the WB finding that even in the realm of job creation, SMEs have performed poorly. The finding might not be contradictory since SMEs in Europe and the US include large companies by most developing world standards. Even in countries where SMEs and micro enterprises are numerous, their numbers indicate that they can barely maintain themselves let alone generate extra employment. The association of SMEs and innovation also works in a detrimental fashion to job creation. Innovation of the technical kind, is usually associated with saving resources, thus labor as a production input is reduced. What makes innovation conducive to job creation is the circle of large-scale imitation it engenders. However, in developing countries, what is being proposed in relation to innovation is more accurately describes as de-innovation. The WB's enframing of SMEs as job placement agencies in effect propagates the de-innovative character of these enterprises. The aim of the WB is not to achieve a middle level technology, produced by utilizing the best technology available, instead to make available dated technology for developing SMEs. The theory is that the capital intensive nature of these SMEs will lead to more intensive use of labor. Innovation as understood earlier as being a mechanism for conservation of resources and optimization of outcome is absent from this utilization of the term. This is so to speak rightly so since most SMEs in either developing or developed countries, are in a position to achieve regular system changing innovations on the scale that Schumpeter envisioned. Appropriately, the innovator, the Schumpeterian entrepreneur is missing from this de-innovative picture. Schumpeter, in his emphasis on the role of banks for financing

¹⁵⁶ OECD Globalization and Small and Medium Enterprises (SMEs) Paris. OECD. 1997. p 7.

entrepreneurs, was keenly aware of the structural support these need to prosper. SMEs can learn and innovate, not all will, but their numbers must be big in order to create the possibility for the emergence of competitive successful institutions. In opposition to the WB's market approach, this paper has argued along the lines of those advocating institutional support for SMEs.¹⁵⁷ The entrepreneur has had many features in SME literature. Over time, the innovative ability has been de-emphasized and the risk taking, and paradoxically, managerial aspect of the entrepreneur have been emphasized. Entrepreneurship, in the WB terminology, has been linked to risk taking and management, and less so to innovation. Business like culture and management techniques are attributes that support SMEs are in turn supported by them. The Bank advocates a business culture, not just in SMEs or their supporting institutions, but also in NGOs operating to help SMEs prosper. However, the practice of lending to SMEs changes the desired results. Because of the move towards sustainability and private financing of SMEs through banks, effectively means that what gets developed are the managerial and accounting skills of SMEs and not risk taking or innovation. Business culture in SME literature replaces 'scientific thinking' in early industrial discourse describing in a less colonial tone, what is needed in the developing world. Early development theorists such as Bauer and Bhagwati commented on the enterprising nature present in most developing countries. Others have echoed their admiration for business like practices. There is no real definition of what a business like culture looks like. The assumption in the UNIDO paper is that business like culture is accountable on a set of standards and focused on financial sustainability. The assumption is that incentives are to be used to generate results and, at the same time, training and learning are to be a continued process in building the business

¹⁵⁷ Henry Romijn Acquisition of Technological Capability in Small Firms in Developing Countries New York. St Martin's Press, Inc. 1999. p 257.

culture needed.¹⁵⁸ Business culture is then an ongoing project. Just as scientific management was a criterion for industrialization, business culture built on incentives and cost-benefit analysis, is a hallmark of liberal development. Business culture is not necessarily grounded in the local cultural makeup. The attack on crony capitalism in East Asia following the 1997 crisis is an illustration of what business culture looks like. In hindsight, the attack on crony capitalism might have been less convincing had the accounting scandals made their way to the light back in 1997. Arguing for business culture has become prevalent in development circles since the late 1980s. The vague language of good governance used as a description, and an explanation of what ails developing countries, shares many features in parallel with business culture.¹⁵⁹ Both are vague concepts that hint at a solution while continuously shying away from providing a solid answer. Lack of good governance is a result of insufficient institutional maturity in society in general. The market discipline is assumed to be able to put in place good business practices. However, the development of this market can proceed successfully only if good policies are implemented. The language of entrepreneurship, which was seeking an explanation of economic change within capitalism, has become a justification and an explanation for why capitalism is a failure in many places and as why it cannot be easily fixed.

The language of SMEs, which began its rise in development with the disillusion with industrialization, has been centered around poverty. The debate between growth and poverty progressed to encompass SMEs. The theory behind SME's contribution to economic development also gained currency with the stagnation of the western economies during the late 1960s and 1970s. Institutionally, SMEs seemed to represent a possibility of renewal for some, or represented a sign for desperation and hanging economic paradigm for others. The emergence of

¹⁵⁸Puff Kazuko Business Development Services for SMEs: Preliminary Guidelines for Donor-Funded Interventions P 31.

¹⁵⁹ Susan George and Fabrizio Sabelli Faith and Credit New York. Penguin Books. 1994. P 160.

flexible production with its destructive effects on organized labor, offered a macro-economic ally to SMEs. However, SMEs have remained institutionally weak and tend to still rely on achieving a certain critical mass before proving themselves economically viable. Whether or not SMEs offer a more human or fulfilling work environment is up to sociologists to decide. What SMEs do exhibit is an ability to sustain high rates of innovation and to display a commendable level of flexibility. This has been the case in Taiwan and S. Korea, and even in Lebanon where industrial SMEs still operate in deplorable conditions. In order to survive, many shed their special product focus and expand to engage in several economic activities at once. SMEs diversify their portfolio of economic services to better hedge themselves against market shocks. Those SMEs linked to specific industries are usually in a subcontracting relationship. As such, they are heavily dependent on the large firm. The question is, can there be an alternative to viewing SMEs as a cushion for SAPs? Can there be a development strategy based on 'small is beautiful?'

The WB one-dimensional treatment of SMEs is insufficient if there is to be an SME based development strategy. The problem is essentially found with the Bank's vision that development is linked completely to the market. That the only time intervention is justified is to remedy a shortfall in the market mechanism. Social funds that aim at supporting SMEs are justified on this basis. But the half-hearted promise of SME based development model as outlined in 1978 has all but been suppressed. The aim is to introduce market mechanism to developing economies. Planning is tolerated only to the extent that it smoothes the operations of the market. Strategic industries, incentives and subsidies are institutional hindrances interfering with the correct price of commodities and services. For this goal, SME services in developing countries should become more market-based and concerned with profitability. Transaction costs associated with SMEs justify charging market rates. These rates in the long run, would ensure the most efficient distribution of resources and achieve optimal results for the economy in

general, assuming that macroeconomic biases have been cleared. The problem is that most banks, unless forced by the government, will charge even higher than regular rates because of associated handling costs of SME lending. They become shock absorbers, just as the case with Japanese subcontractors. The WB is involved in funding many local SME development agencies such as the Egyptian SFD and the social investment funds in Latin America. As shock absorbers, SMEs get rewarded with good descriptions but little material benefits. The Egyptian case is an illustration of an impoverished program suffering from a dual mandate. This is a direct result of over emphasis on macro economic adjustment at the expense of all other policy imperatives, including SMEs.

What is needed is in fact the opposite of what the Bank advocates. In another short study regarding SMEs in Asia, especially outside of the Newly Industrialized Countries, it was found that the best strategy for SME growth is the re-encouragement of industrial activity.¹⁶⁰ This is not to be the same kind proposed by the early development theorists, but an expansion of industrial activity to include rural SMEs and create enough activity so that in the future, those successful and internationally competitive 5% of SMEs can emerge and help the economy along. Manufacturing has been and continuous to be the main generator of economic growth for most of the world in general and developing countries in particular.¹⁶¹ This means in effect a policy of supporting manufacturing industries and promoting their growth. We saw that in Asia, Both Taiwan and S. Korea play an active role in promoting their manufacturing SMEs. Industrialization was also advocated in the rural industrialization report published by the UN in 1991. Thus, there seems to be a movement that presenting itself in a counter-hegemonic fashion, against the leveling mechanism of liberal ideology propagated by the Bank and its affiliates.

¹⁶⁰ E. Desingu Setty Rural Industrialization, Small Scale and Cottage Industries in Asia United Nations Center for Regional Development, Japan. 1991. P 7.

These calls for re-industrialization, are different in nature from those first proposed by first generation authors. The aesthetics of this movement is different. Large scale factories producing uncompetitive machinery and requiring the utilization of all available resources are not what the new industrialization should look like. Partially, the new industrialization should head some of the lessons learned during the rise of the Asian countries, specifically, S. Korea and Taiwan. This industrialization is built on an economic integrationist policy that links the state, the banking systems, the educational system and the productive sectors of the economy to construct a virtuous circle. The conditions that led to this combination are unique. Thus, they cannot be emulated. However, they can be followed in spirit if not necessarily in form. The new form of industrialization can be an alliance between the state and society in order to produce competitive, small enterprises that have the potential to develop to larger ones and at the same time, play a role in reducing poverty and increasing innovation. The strategy needs commitment and involvement, something that the WB has been working against.

Conclusion:

SMEs can be successful and can contribute significantly to an economy. However, the language associated with the rise of SME discourse in development circles is of specific function. The discourse of SMEs within the development industry has grown as a mechanism against planning and attempted industrialization drives that were pursued during the 1950s, 1960s, and 1970s. This in turn is a reflection of the changes occurring on the international market away from fordism into a financially dominated system known as post-fordism. The discourse had a nominal goal; the humanization of the development process and the inclusion of the poor. The discourse developed hand in hand with the changes in the global economic

¹⁶¹ Carlos Sabillion Manufacturing Technology, and Economic Growth New York. M. E. Sharpe, Inc. 2000. P 334-

structures referred to as post-fordism. These changes helped speed up the end of the fordist promoted planning state and replaced it with the liberalization formula. SMEs became a tool to promote the culture of liberalization and free enterprise, and to limit the fall out of these policies, but they were never considered as a potentially viable alternative to industrialization. No alternative was needed in any case. The liberalization school is not content with alternatives. These imply too much agency in a system that is supposed to work by free flowing self interest. The alternative model to development developed by the second-generation school has boiled down to no plan. The plan is to stabilize macro economic performance, liberalize trade regimes, and privatize assets. There was no industrialization strategy to pursue, nor was there any additional strategies offered. It is to this debate that SMEs fell. Originally, the theory of basing a development theory around SME was advocated, first by Schumacher and later in the 1978 WB report regarding SMEs. However, Schumacher's vision was too idealistic to pursue and making SMEs economically viable proved too difficult a task for the bank. This is the most important lesson to be learned from the Bank's dealing with SMEs. Substantial investment in capital, technology and human resources is needed over time in order to create an effective SME sector. This sector in turn can be effective only if it co-exists with a large sector that can help the development (and sometime hinder it as well) of the SME sector. Size still matters. The early development theorists were philosophical in their outlook. They looked at fundamental flaws in the developing world and sought to remedy them. The World Bank lacks philosophy, it has methodology, and although vehemently denied, an ideology. Development has ceased to be the issue and has been replaced by integration. Others in a post-colonial school might call it mimicry. The attempt, self-induced and external, is to make the colonial subject resemble the colonizer. This is not to say that the WB is a colonizing force. What this is trying to say is that

reductionist understanding of development, not as a life force, but as an economic equation misses the point. The East Asian example also does not offer a pathway laden by desire. It does offer a possibility of economic development, which is encouraging for many other nations, especially those close by to the area. More pertinently, SME specific discourse has opened up doors, but only as an entry of specific style of debate. The SME movement within the WB and other development agency has come, as has been mentioned, as a result of the disillusionment with the traditional developmental practices. As such, the debate brought forth genuine points of concern. Furthermore, action within the field of SME, although inadequate, has not been unwelcome. At least, it offered temporary jobs to many otherwise unemployed PhD students. The World Bank discourse brings with it the language of change as well. No matter how hollow, rhetoric can have powerful appeals. Thus, the inclusion of NGOs, women and the environment in the list of concerns that the Banks expressed regarding SMEs is bound to have an effect. The question becomes, how long can the discourse be continuously utilized to promote one agenda on the expense of others. The Bank is making no secret of its wishes to turn NGOs dealing with SMEs into business like organizations. The experience in East Asia shows that business like concerns are somewhat short sighted and that the field requires continuous support in order to be economically viable. The emphasis on the business like nature of NGOs dealing with SMEs is contradictory in nature. It suffers from the same contradictions that ail the Egyptian credit Guarantee fund, and many other funds aiming at delivering a social good with business like management techniques. The end result is a poor service by financial standards that reaches few of its intended recipients.

SMEs form a special category of institutions, because of long tradition and specific cultural historic ties to communities; SMEs are more than a simple economic unit. They embody some elements within the culture, conservative elements most of the time. However, since they

have cultural aspects, and since they form part of the fabric of many societies, the strengthening of these institutions presents an attractive opportunity to engage the public in the development process. A strong SME branch is very conducive to economic activity in general. However, for this to take place, SMEs need to be regarded as more than poverty alleviating mechanisms. Economically, their role as a conducive member of the economic society, that is able to participate in the development process must be enhanced. This is done through focusing on SMEs as a part of a wider development strategy that aims to transcend the disadvantages of smallness while retaining the benefits. Thus, a healthy SME sector needs to develop alongside a healthy industrial sector, both feeding off each other, competing, and enjoying the services of different institutional mechanisms. Only under such a scenario will the promised benefits of SMEs as innovation powerhouses and employment and cultural centers, be realized. Culturally, SMEs do open up a possibility of engaging the rural population, the poor, and women in the process of development on a more sustainable basis. These needs to be done on a scale beyond the scope of micro finance, it needs to be a strategy linked to environmental issues, gender issues, and economic factors and determinants of competitive advantages. This paper has not presented a strategy for success for SMEs, but these last thoughts serve as an indication that there is something valuable in this field that has been colored with one vision and obstructed from becoming a diverse point of intersection.

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