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Financing Local Development in South-East Europe: Rediscovering the Crucial Role of Community-Owned and Controlled Finance

Milford Bateman

Faculty of Economics and Tourism, Juraj Dobrila University at Pula, Croatia: International Development Studies, St Marys University, Halifax, Canada: Future Forum, Phnom Penh, Cambodia

The background

- Following end of the former Yugoslavia in 1989, the international development institutions (IDIs) principally the World Bank, IMF, European Commission and USAID, arrived ‘to assist’
- They had ‘a grand plan’ to restructure the economies and societies of SEE irrespective of what local people wanted
- SEE governments instructed to deploy the simplistic free market ideology known as neoliberalism, or the 'Washington consensus'.
- No matter that neoliberal policies were a failure in Latin America in the 1980s, and in the western countries themselves after 1980
- And, anyway, many political economists see these neoliberal policies were mainly about principally benefitting the western economies not the SEE economies

The results of 30 years of neoliberal policies

- This approach to reconstruction and development has created a calamity in South-East Europe for all but a narrow domestic elite, as evidenced by:

  - declining living standards
  - accelerated deindustrialisation
  - massive rise in corruption and fraud
  - high/hidden unemployment and forced migration
  - worsening public services
  - deteriorating public infrastructure
  - multiple privatisation failures
  - massively increasing household and public debt
  - major financial flows to west as a result of local company purchase
  - spectacular levels of inequality
  - democracy subverted rise of tycoons and oligarchs controlling governments

- It was only thanks to the EU's financial assistance and migration to EU, and also short term impact of FDI, that since the late 1990s an even *greater* economic failure was narrowly averted

- And then in 2008, global neoliberalism itself began to collapse, beginning in the USA on Wall Street and then rippling all around the world, including negative impact on SEE

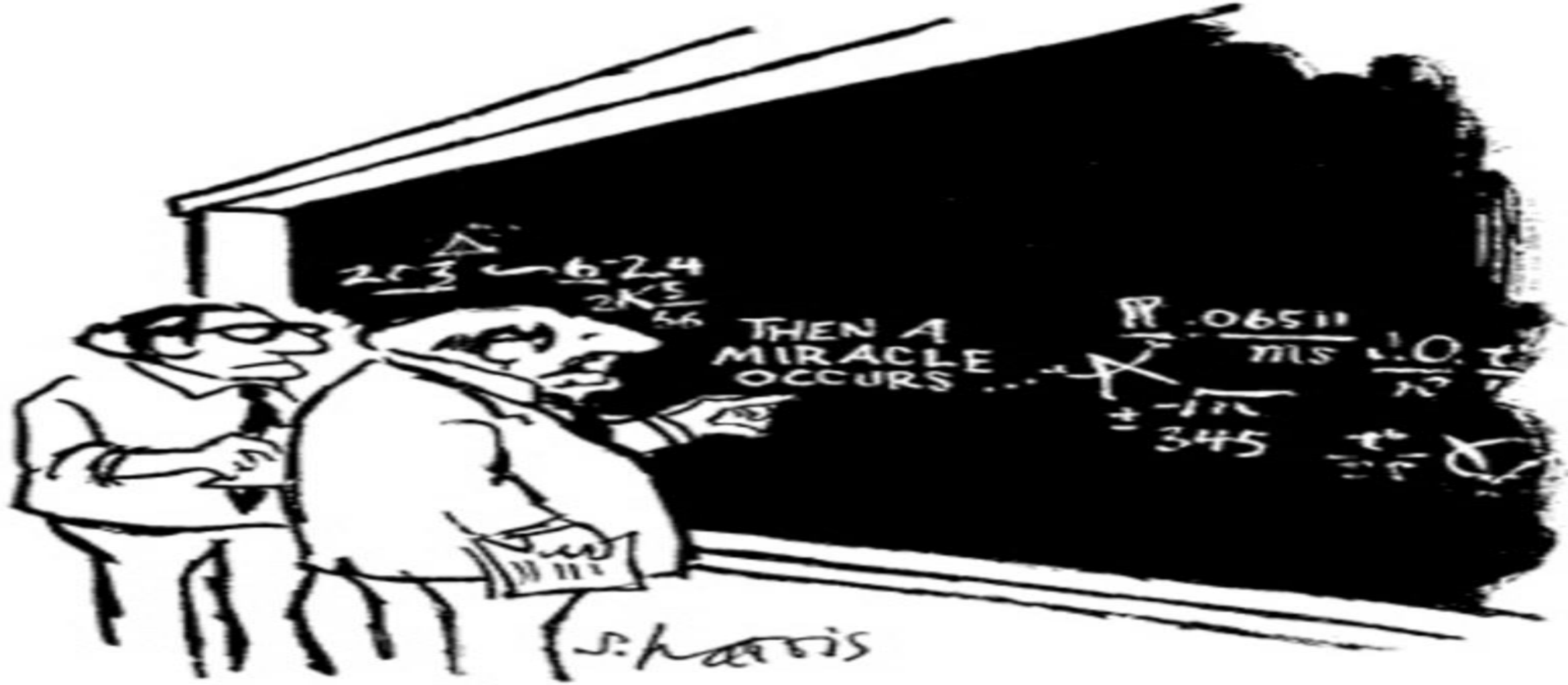
The reaction to the failures of neoliberalism

- Elites in all SEE countries did fine, so promoted the view that everything turned out great and that there was no alternative
- Tycoons all supported neoliberal policies, especially privatisation, as it opened up huge opportunities for them to profiteer
- Politicians, central bank governors and senior staff at World Bank and IMF drawn from SEE countries say nothing since they want to joint the global elite and smear critics of neoliberalism as ‘communists’
- Wider population knew something went wrong – termed ‘*Yugo-nostalgija*’ - but few politicians, political parties, economists or media outlets supported real alternatives based on German or Japanese experience after 1945

Key aspects of the neoliberal financial sector reforms demanded by the IFIs

- Privatise all financial institutions
- Assume all financial institutions will lend responsibly
- Delete all controls on capital flows (mainly so as to aid profit repatriation by FDI-led foreign companies)
- Forced abandonment of all efforts to establish development financing/banking models
- Deregulate and desupervise all financial institutions
- Lending henceforth to be based on narrow short-term profit calculus only: long-term patient capital lending naively considered to be ‘ideologically suspect’ (too much like central planning)

The IDIs had a blind faith in neoliberal policy parameters



"I think you should be more explicit here in step two."

The results of local neoliberal financialisation?

- As predicted by Amsden, Kochanowicz and Taylor (1994), SEE rapidly deindustrialised, informalised and primitivised at least partly as a result of its local neoliberal policy framework:
  - Local financial sector emerges as US-style extractive and short-term profit-focused, not East Asian-style development-focused
  - SME sector ignored, many banks simply ‘invest’ in government bonds or 7 day money market rather than invest/lend locally to SMEs
  - SMEs supported mainly importing businesses since have instant cash flow and ready market access (e.g., ‘sale or return’ agreements with western producers)
  - ‘Stuffed and starved’: short term unsustainable but profitable projects get as much as funding as they want, while good long-term business projects go unfunded
  - Major frauds, speculative and exploitative excesses caused by lack of supervision and regulation
  - Rise of destructive ‘boom-to-bust’ reckless lending-driven dynamics:
    - Croatia household debt/GDP largest in Eastern Europe, and when reversed resulted in major loss of household collateral and massive social disruption
    - Rise of microcredit in Bosnia creates a boom to bust disaster, only now unwinding with donor help

The urgent priorities today

- Creative use of development banking to support key growth-oriented businesses – not every development bank has succeeded, but there are no examples of a country that has succeeded WITHOUT one (Amsden, 2001; Chang, 2010)
- Rebuilding and re-launching local community-owned and controlled financial institutions – need to bring back control over finance to the community
- Major re-regulation of financial sector
- Supervision capacity needs upgrading
- Prohibit risky Wall Street-style interventions, such as securitisation, which can explode the system if/when all goes wrong

Successful heterodox local alternatives to examine

- Post-war West Germany, northern Italy, Basque region of Spain and Scandinavian countries pioneered different local 'developmental' financial models

- East Asian countries (Japan, Taiwan, S Korea, Malaysia, China, Vietnam) all opted for a local 'developmental' financial model which very much succeeded

- Latin America with its 'Import Substitution Industrialisation' (ISI) project from 1960s onwards generated many gains, including building substantial SME sectors (Amsden, 2001)

- All of these local financial models:

  - put an emphasis on careful local investment and capacity building in key industries, sectors and individual enterprises

  - Built major local eco-system of support for enterprise development, including technical, technology and business support

  - Worked with 'local content agreements' to build local capacity

  - favoured major role for local technology adoption and learning

  - Were willing to use subsidised financial support where necessary

Three types of local financial institution needed in SEE today

- Local/municipal development bank:
  - can develop real capacity to intervene and risk-take (not just act like a commercial bank)
  - can ‘crowd in’ private investment by leading on projects
  - can seek technology alliances with western European institutions
  - can issue bonds to local markets and EU paying tiny but positive returns

- Financial cooperatives:
  - can stimulate local savings mobilisation
  - can indulge in SME lending using local knowledge (Becattini’s ‘theory of the local bank’)
  - can disburse profits to local savers/owners underpinning local demand

- Credit unions:
  - ideal way to underpin small-sale consumption lending
  - Exist to **avoid** excessive household indebtedness, not **encourage** it

Conclusion

- Clear that neoliberal policy parameters were a disaster for the SEE region
- Especially with regard to financial sector reforms
- However, a major disaster unfolded after 1990, exacerbated by the collapse of the neoliberal model itself in the USA in 2008
- Urgent need now is to rebuild finance for development Japan/Germany/China-style, not finance simply for profit US/UK style
- Need to look at other successful models in practice rather than deeply flawed Chicago School theoretical models of efficient markets and responsible agents
- New local financial institutions need to be established, funded and energised in order to create a sustainable ‘bottom-up’ economic development trajectory