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The Informal Sector in Central America:
A View on Conceptual and Operational Environments
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THE INFORMAL SECTOR IN CENTRAL AMERICA; A VIEW ON CONCEPTUAL AND OPERATIONAL ENVIRONMENTS

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I. Introduction

Contrary to the conventional wisdom of homogeneity, Central America is a small sub-continent of great diversity and striking contrasts due to differences of ethnic composition, class, levels of development, urbanization and socio-political systems.

On a country basis, El Salvador is the most densely populated with 268 inhabitants/sq.km. and Nicaragua with only 23 people/sq.km. Panama shows the highest level of urbanization with 61% of its population living in urban settings, followed by Nicaragua with 60%. Guatemala presents the lowest urbanization level with 41% of its population living in cities.

Similarly, socio-economic development also shows significant variations. Life expectancy at birth in Costa Rica is 73 years and El Salvador 53 years, countries which also represent the highest and lowest income distribution indices of their populations, with a 6% of the national income accrued to the poorest 20% of the population in Costa Rica and only 1% for El Salvador. *

As of 1987 Guatemala (8%) and Costa Rica (9%) showed the lowest levels of open unemployment and El Salvador (29%) and Honduras (22%) the highest. Per capita income remains quite apart -- US\$750 for Honduras and US\$2200 for Panama. **

* SIECA, 1986.

** Inforpress Centroamericana, 1984.

These and many more statistics provide the basic elements to describe and analyze the so-called "Informal Sector" in the sub-continent and to draw some conclusions which will serve to identify both policy and operational implications for the future.

The purpose of this paper is to examine the policy and operational conditions which affect the situation and performance of the Informal Sector in Central America.

The information on the Informal Sector in Central America is both scarce and fragmented due mainly, to the lack of consensus about a standard definition and the intrinsic nature of the sector which is also called the "under ground economy of a country." With the exception of El Salvador, the term "Informal Sector" and the concept were alien to the Region as recently as the early 80's. Only in recent years, thanks to the work of ILO/PREALC and several NGOs, the concept, role and activities of this sector have received concerted attention from governments, international agencies and NGOs.

Previous to its present name, the sector, perhaps with different limits was known as the traditional or backward sector, artisanal, second economy, marginal or, as in most countries of the Region the sector of small producers and/or entrepreneurs. These different names are still playing a significant role in shaping the current concept of "Informality" which is in the midst of severe scrutiny by policy makers, scholars and practitioners of development in the area.

No matter what name is utilized, the different forms of the Informal Sector have been known in the Region since the establishment of the first urban settings and the appearance of market days. They are now part and parcel of market economies of each and every country in Central America. Moreover, and depending upon the cut-off division between formal and informal, the latter appears to be growing

at a much higher rate than the formal sector, --between 5% and 15% for Costa Rica and El Salvador respectively. *

Particularly important is what is now called the "Urban Informal Sector" (UIS) which is considered to play an important role in the patterns of urban-rural migrations. First, as a transition or waiting sector for the rural workers before entering the formal or modern sector when this is in expansion and then in times of crisis or recession the UIS is a reservoir for the surplus labour laid-off by the modern sector. In this context, in the view of several practitioners and scholars including the author, the sector will continue to grow while urban-rural migration and recessive growth persist in Central America.

A great number of studies of a partial nature continue to show a strong relationship between the growth and dynamics of the Informal Sector and the performance of the economy as a whole. Apart from the cyclical effects of development (expansion, recession) further aggravated by urban-rural migration, the restriction on imports due to the heavy external debt, the price fall of primary commodities exported by the region, the overvaluation of national currencies, the level of inflation, the decline of domestic aggregate demand and the like, all seem to have an either direct or indirect effect on the size, characteristics, behavior and performance of the Informal Sector.

In sum, any event generated both external and/or intrinsic to the national economy which has a direct effect on the labour market and on the reorganization of the production process and consumer market has a direct bearing on the Informal Sector in the Central American Region.

2. Conceptual and Operational Considerations

In Central America, as well as in the rest of Latin America, the societal and governmental goal is to be part of the newly industrialized countries club before the end of the century. Under this premise,

* PREALC based on Household Surveys and censuses 1980 to 1988. The same estimates indicate that about 30%, 45% and 28% are informal, formal and domestic workers in the large urban centers of the region.

governments strongly encourage and support the larger-scale, capital-intensive and export-oriented enterprises. The industrialization and modernization banner has brought about an accelerated urbanization and monetization in all countries of the Region. Thus, the urban and rural labour markets are becoming more interdependent with an ever increasing number of rural dwellers performing more and more non-farm income generating activities for their livelihood.

On the other hand, the modern industrial, construction and transportation sectors have not been able to absorb the displaced rural workers and new entrants at a reasonable rate. Although for the last 5 years the output of the manufacturing sector has grown in all countries, except in Nicaragua, unemployment and, most of all, under-employment rates have increased.

Perhaps the most important structural element that has influenced both the size and dynamics of the Informal Sector is the on-going worldwide economic crisis, which has created recessive and sometimes depressive conditions in all countries of Central America being even worse for Nicaragua, El Salvador and Guatemala which are further affected by prolonged guerrilla wars.

There are some estimates that at any given "normal time" about 35% of the EAP is subjected to the effects of the incapacity of both the primary (mainly agriculture) and the modern (mainly industry) sectors to absorb the increasing and rejected labour force, and, depending on the magnitude and duration of recession periods, the displaced EAP from the formal modern sector, could reach about 60% of the private workforce in some countries, such as the case of El Salvador in 1980. *

Due to the heterogeneous nature of the Informal sector there is no standard definition which has a regional application. Each country has established its own definition and several national approaches are

* Dirección General de Estadística y Censos 1980, Cida Micro and Small-Scale Development in Latin America 1980

found. The closest regional attempt to define the sector stems from the Central American Agreement on Fiscal Incentives for Industrial Development, which makes use of both qualitative and quantitative elements to characterize the small-scale Industrial Enterprise, this includes a maximum of 30 workers and US\$50,000 of fixed assets, simple technology, owner as part of the productive process, intensive use of national/regional inputs.*

It's obvious that this general definition does not specifically refer to the Informal Sector, but its qualitative elements have served to formulate more specifically oriented definitions.

From the studies so far generated in the area, is possible to identify four schools of thought which have produced some sort of definitions of the Informal Sector:

1) For the PREALC group the sector is "the combination of independent, occasional and waged workers, non-waged family workers and minors and employers performing income-generating activities in enterprises of less than 4 people". ILO, under the same employment-generation perspective adds: "is of easy entry, of family ownership, using domestic resources, labour-intensive, operation, in reduced scales, using techniques acquired outside the formal system of education and characterized by operating in non-regulated and highly competitive markets"."

In general terms, this appears to be a very broad definition which at times includes formal micro enterprises and excludes some larger enterprises which are operating in an informal manner due to their market position and level of marginal incomes.

2) For a good number of scholars, the sector is defined according to the level of under-development in which the population and the

* SIECA, 1976.

** EUPAD, Forum Centroamericano de Inst. Privadas de Desarrollo 1985

enterprises are forced to operate, in other words the Informal Sector "is a section of the population which has limited or no access to the modern markets of labour, products and inputs and forced to work with marginal resources to survive".*

It's then a segment of the population living and working in marginal conditions or below a certain "minimum level" or standards of living. In this context, informal is equivalent to poverty or pauperization.

It is obvious that this definition is mainly providing a new name to poverty, however, it contributes very little to explain the characteristics, performance and dynamics of the sector, neither its relationships and articulation with the formal sector and the rest of the economy as a whole. Therefore, policies and programs of poverty alleviation are often considered as those oriented to the development of the Informal Sector.

The next two schools are considered more pragmatic.

3) The first of these definitional approaches stems from the structuralist school of ECLAC which is based on the structural differences between and among the different economic sectors and activities generated by the uneven penetration of software and hardware technologies and capital which in turn create economic units characterized by low productivity and incomes and by the use of a combination of pre-capitalist and capitalist (traditional and modern) modes of production.

For this group the Informal Sector is that which makes use of a combination of factors of production dominated by a low (or very low) capital/labour ratio which takes place in economic units of a very reduced scale.^{**} Thus, in operational terms, the emphasis is on the size

* Reardon, 1979

** EUPAD, 1985

of enterprises conforming the sector which are called "small-scale Units" (SSUs) and policies and programs are aimed to create the appropriate conditions to allow the SSUs to realise their potentials and encourage and support their insertion and articulation with the formal/modern sector.

Perhaps the main objections stem from the fact that the division between small and micro-enterprises is always vague and mostly related to the size of the national economy and its level of development and the very strong assumption and sometimes misleading idea that informal activities are less productive by nature. *

4) The final definitional approach is considered to be the most practical and operational and it was developed by Peruvians based on their experiences in the south-coast of Lima. For this group the Informal Sector "functions outside of the law, or in other way, performs licit tasks in an illicit manner" by having no official permit (patente), paying no taxes, paying no social security. **

According to this group formality in Latin America is a privilege of selected groups with the financial and knowledge capability to afford the complex legislative and regulatory procedures governing modern economic activities. Furthermore, they assume that the existing regulatory, legal and developmental instruments discriminate against these activities forcing the members of this sector to perform income-generating activities outside the law. Thus, policies and programs designed to support the Informal sector are aimed to promote and organize its members to create pressure or lobbying groups able to influence policy-and law-makers in favour of the Sector to allow it to operate within the boundaries of the law. The slogan is "to make more formal the informals and more informal the formals".

* Alternativas de Desarrollo, 1987

** Hernando de Soto, 1987

At a first glance one can realize that the emphasis is on the legal aspects of the activities and enterprises and that the improvement of the sector and its population will have to come from a more flexible and tolerant legislation at all levels, (central, provincial and municipal). The emphasis is also on the qualitative aspects of the population and its living and working conditions. Perhaps the most serious contention to this approach is (by its practicality) the abrupt dichotomy or division between formal and informal with little or no space for a great number of people and enterprises operating at the fringe (grey area) of these two boundaries and thus ignoring the structural and functional relationships between the two sectors. It appears to be a revival of the dualistic tradition of the 50's and 60's which has been severely criticized.

However, despite the weaknesses and criticisms of all approaches there are serious attempts to properly address the "problematique" and developmental potential of the so-called Informal Sector. Thus, the supportive actions oriented towards the sector in Central America are being pragmatically and functionally defined as those provided to "all micro-entrepreneurs who has a small establishment (workshop, stand) and working either inside or outside the law". *

As one can observe, in this approach one can find a combination of definitions where the basic thrust is to provide needed services to any individual or small establishment who has not been served by the formal and institutionalized assistance delivery system. Thus, the emphasis is on relative access to existing support services which assist the development of income-generating activities.

As expected at the government level, the Informal Sector as such, is not recognized in all countries and only tangential measures are applied to support the Sector. There are general policies and plans that provide a small niche to orientate actions towards the Sector. The

* Consensus definition reached by 24 NGOs working in the Region during the First Conference on Private Support Institution to Small Enterprises INCAE, July 1985.

emphasis in most cases is on employment generation and maintenance of small enterprises with preferential treatment for the industrial sector.

The above orientation is in line with the general view that the chief problem of small entrepreneurs is that they have limited or no access to the modern product and factor markets due to price distortions introduced by monopolistic/oligopolistic market competition. Therefore, efforts to support small enterprises are centered around mechanisms to reallocate and transfer resources to small producers.¹ This is performed via subsidized credit, tax exemptions, preferential exchange rates, technical assistance, training and limited marketing assistance. In this context, the Informal Sector is only tangentially assisted, because, by definition, this sector does not interact directly with the banking, taxing, export/import, training systems.

This review is by no means exhaustive and the search and quest for answers will continue for many years to come and the best that any one can do at this juncture is to center the attention of any forum, such as this, on critical issues and questions to be answered by practitioners and researchers.

How significant is it to have a conceptual and/or operational definition for the Informal Sector if its theoretical underpinning cannot be verified?

How different are the income-generating activities between the formal and informal sectors? or can we establish a cut-off limit between the two-sectors?

Why practitioners equate micro-enterprises and micro-entrepreneurs with the Informal Sector?

¹ Haen, 1985

Can all independent workers be considered entrepreneurs and all of them part of the Informal Sector?

Is formalization equivalent to legalization?

3. Characteristics of Enterprises and Entrepreneurs

So far, the issue of definition has not been resolved, however, several private and government agencies are actively involved in support activities based on practical measures of the upper limits of enterprises by using a combination of quantitative and qualitative elements. As for the former, the most commonly used parameters are the number of employees, assets and sales. More sophisticated measures include capital turnover, labour intensity or a combination of ratios rates which are mostly indicators of performance rather than inherent descriptive features¹.

On the qualitative side, these measures relate to essential operational characteristics which make informal enterprises different from formal modern ones. They include: labour-intensive technologies, ownership and management as part of the production process, limited division of labour and the like.

There are many practitioners and scholars who, despite the absence of a conceptual definition, consider and affirm that the Informal Sector can be empirically recognized and its boundaries established by the type, characteristics and performance of enterprises.^{*}

In this regard, the vast majority of businesses in the Region are part of the Informal Sector. Thus, to simplify matters and avoid the descriptive and explanatory diatribes about individual members of the informal population, this paper will center its attention on the economic units performing income-generating activities in the so-called Informal

¹ Singer, 1982; Harper, 1984

Sector and, for more specificity, it will consider rural and urban non-farming activities performed by the private sector.

The general characteristics do not differ from the features of most informal enterprises in the rest of Latin America, and the world for that matter. Some of the most relevant characteristics are included below only as an aide-memoire:

Statically

- Personalized and diffuse production and managerial structures
- Predominance of manual work by using labour-intensive, second-hand or salvage technologies.
- A reduced size or scale of operation both in terms of capital and participants
- Absence of specialization and/or division of labour
- Predominance of unskilled or semi-skilled and family workforce

Dynamically

- Truly competitive with easy "entry" and "exit" in the market
- High degree of proliferation, especially in areas of low income markets
- High degree of flexibility which is accompanied by high rates of "birth", "transformation" and "mortality"

From the above, the characteristics, potentials and constraints can be derived. They have been fully described and analyzed in several reports and studies. But, this paper will concentrate on the more distinctive features of informal enterprises and their entrepreneurs in Central America.

They are, for the most part, unregulated but partially enumerated by proxy, from the statistics of the ERP derived from a standardized regional procedure applied by all countries (censuses and household surveys).*

* Haen, 1986

Similarly, the great majority of informal enterprises participate in the modern market of inputs to acquire machinery, equipment, raw materials and supplies in general and a considerable number participate in the modern product markets. This does not imply that informal enterprises are not participating in low income markets or in recycling of technologies, wastes or residues.

There exists a good number of cooperatives, solidarity, groups and other forms of associations compared to the rest of Latin America, especially in Costa Rica and Nicaragua. This feature tends to facilitate the delivery of assistance.

A good number of informal enterprises have been established out of the fragmentation of larger firms, out of privatization of services and by laid-off and early-retired employees of the formal private and public sectors. In general terms, enterprises evolving from the formal sector tend to perform better and placed in the larger scales of informal enterprises than those started by the non-experienced entrepreneur. However, for the most part the informal enterprises are involved in services and trade (60%) activities.

The informal entrepreneur presents also some particular features:

- Fairly young with an average 30 years of age (54% of entrepreneurs are in the range of 25-35 years of age)
- Highly mobile (60% are migrants either from rural areas or other cities with no more than 5 years of settlement)
- More than three quarters of the entrepreneurs have learned their trades outside the formal educational system
- More than 50% of the entrepreneurs have complete primary education and only 30% are women
- The great majority (70%) has worked in more than 2 different activities. Showing "expertise" mostly in trade and manufacturing activities.

As for the workers, the picture is not so different and the major discriminating element is in degree or level of the above features:

- Average age is about 20 years of age including a good proportion of minors, up to 65% of the population between 10 and 14 years work in the Informal Sector.
- Up to 75% of its workers are considered to be part-time or temporary, family-member or apprentices.
- The average level of education is below 3 years of primary formal school.
- About 70% are migrants with less than two years in their place of work.*

4. Performance of the Informal Sector

Tables 1 and 2 illustrate the significant differences between and among countries to allow the reader to appreciate and analyze the role and articulation of this sector in the economies of the Region. The author believes that this aspect has been tangentially covered and deserves a detailed and separate treatment.

TABLE 1
Urban Informal Sector Employment
and its composition, 1982

	Urban Informal Sector employment	Independent workers	Waged-workers	Family Workers	Employers
	%	%	%	%	%
Costa Rica	23	47	38	6	10
El Salvador	40	63	27	8	2
Guatemala	30	64	27	5	4
Honduras	29	52	37	3	8
Nicaragua	35	69	20	8	5
Panama	14	71	20	3	6

SOURCE: Haan, 1985.

* EUPAD, op.cit., 1985

Table 2
Informal Employment by Economic
Activities

	Costa Rica % a)	El Sal- vador % b)	Guate- mala % b)	Hondu- ras % a)	Nicara- gua % a)	Pana- ma % a)
Manufacturing	21.2	18.2	20.2	14.2	20.6	13.6
Commerce	41.7	42.3	35.1	41.2	46.6	33.1
Services	27.9	33.2	30.1	34.6	28.8	34.2
Construction	7.9	4.5	10.8	9.7	2.9	13.0
Others	1.3	1.8	3.8	0.3	1.1	7.1

Sources: a) PREALC, 1985; b) SIECA, 1986.

In general, the Informal Sector's performance is greatly affected by a combination of structural and operational constraints and potentials. As for the former, the most serious appear to be the lack of political will and a hostile legal, financial, technological and organizational environment. This is expressed by the reluctance of government agencies, chambers and associations of commerce and industries and labour unions to incorporate informal enterprises and entrepreneurs into the mainstream of social, economic and political activities. The most relevant potentials stem from the low capital requirements, flexibility and resilience characterizing informal enterprises.

A brief country summary is included to provide indications of the sector's performance. There is growing recognition of the Informal Sector in each of the 6 countries studied and, by all accounts, its size is steadily increasing in terms of working population, number of establishments, economic participation and coverage (activities, areas and markets).

A. Costa Rica

The Informal sector in this country is the second smallest of the other countries. This represents only about 14 per cent of the total EAP (1982). However, recent estimates indicate that by the end of 1987 this could reach 19% at the national level and 28% in urban areas.

The sector appears much more organized (through associations, solidarity groups and cooperatives) and better informed than in other countries. The micro-entrepreneur is a little older more educated, less mobile but requires more capital to establish his/her business.

Another interesting feature is the high proportion of micro-industries--about 24% of all subsectoral activities.

B. El Salvador

The informal sector is widespread and well recognized since it represents the highest percentage (40%) of employment in the country and is greatly influenced by activities in the subsectors of commerce and services (domestic service excluded). Due to the socio-political condition, the country is being subjected to drastic changes and the UIS is rising quite rapidly. Micro businesses are quite unstable and mobile with a limited lifespan (an average of 4-6 years).

Both the work force and entrepreneurs show a high level of illiteracy and/or a very low levels of education. Similarly, a very high proportion (69%) are rural migrants of recent origin (no more than 3 years). In most cases the point of entry is through the domestic service and construction, the next phase is normally trade and service repairs. Despite the interest and participation of government and NGO's, the sector remains quite unorganized and scattered.

C. Guatemala

Despite the fact that informal activities appear much more widespread here than in the rest of the Region, the term informal remains little known. The enterprise of predominance is of family origin with limited mobility. The manufacturing sub-sector shows a great proportion of artisanal production. The entrepreneur has limited education but a "great" working experience, an average age of 40 years and mostly male (88%), with a most limited knowledge of institutional support (for credit, T.A. Training).

D. Honduras

The Informal Sector has been recognized only recently by government and private institutions. It appears weak and less spread than other countries, however, the on-going crisis has brought about a significant resurgence, especially in large cities.

These micro enterprises are characterized by a very low level of technology (recycled equipment) and the marketing of traditional commodities, i.e. food, garments, leather, pottery, furniture, etc. They normally cater their products and services to low income markets with substandard goods. There is little association or economic relationship with the formal sector of the economy.

Entrepreneurs and workers show a very low level of education and/or training and very high mobility both because their recent rural origin and the short lifespan of their markets and therefore their production activities.

E. Nicaragua

Due to its difficult political and economic situation, the country is showing a significant increase in both urbanization and the level of informal activities, especially in the subsectors of commerce and services. PREALC estimates indicate that 70% of the employment in commerce and 62% in services (including transportation) are informal.

The micro enterprises are very small in terms of workers (1.5 per business), capital (US\$350) and sales. The use of family (mostly unpaid) labour is also common in this country. The tendency (supported by the government) is towards our organized movement through cooperatives.

The great majority of entrepreneurs are indeed independent workers with limited entrepreneurial experience (2-3 years) (the lowest in the region) and mostly of rural origin.

F. Panamá

This country is also under severe political and economic stress and, accordingly, the Informal Sector shows rapid growth in the last few years. Because of the large proportion of public sector employment, the Informal Sector is the smallest (proportionally) of all countries in the Region.

The enterprises are relatively, well organized and larger than other countries (similar to Costa Rica) both in terms of workers (2.7 workers per unit) and capital (US\$1,800). They are fairly well distributed among subsectoral activities services: 36%, commerce 33%, manufacturing 14% and construction 13%.

The entrepreneur shows a good level of education, expertise, stability and is well informed of business opportunities.

5. Implications for Institutional Support

Several critical conclusions can be drawn from this description. In summary they are:

-Systematic knowledge of the Informal Sector varies significantly in the Region. The sector is very well known in El Salvador and Costa Rica and practically unknown in Guatemala. The same is valid in terms of public and private actions to support informal income-generating activities.

-Despite a clear definition or cut-off limit, the Informal Sector is growing quite rapidly in all countries due to the reduced absorptive capacity shown by the modern sector and the continued urban-rural migration further exacerbated by the cyclical recessions affecting the Region during the last 15 years.

-There still is reluctance on the part of governments, the organized private sector and labour to pay attention and to allocate resources to support informal activities.

-Several voluntary organizations, mainly assisted by international donor agencies, are participating in support of the sector and creating the necessary conditions to allow a greater recognition and/or a less discriminatory environment and, in some cases, specific legislation in favour of the sector.

Implications for National Governments

The first set of recommendations involves:

-An appraisal of the magnitude and role of the sector in the economy which entails a proper operational and conceptual definition according to the conditions and interests prevailing in each country of the Region.

-A removal or modification of the most damaging regulatory procedures affecting the economic performance of the sector. This also implies the opening of existing assistance mechanisms, i.e. credit, training, technical assistance, marketing to informal users.

-The formulation and operationalization of national programs to support the development of the sector aimed at coordinating the actions of governmental and non-governmental institutions towards the organization of beneficiary groups.

Implications for National NGO's

-Greater coordination among and between NGO's is badly needed. Thus, integrating and/or coordinating mechanisms must be found to provide a better service to the sector. Federations or associations of NGO's should be established to share experiences and "distribute" the work according to their experience.

-Large NGO's normally funded by donor agencies and mostly located in capital cities, should encourage and promote local voluntary groups or development organizations which are closer to the problems and needs of informal entrepreneurs in intermediary cities and towns or local market places.

-Perhaps the main goal of NGO's should be the promotion of a greater awareness between the Informal Sector and its formal counterpart. Thus, NGO's should promote the organization of informal entrepreneurs and their integration to formal institutions; unions, associations chambers, etc.

Implication for International Agencies

-Donor agencies should express policy-level support for policy formulation and programs which are designed to improve the employment situation and the working environment of informal enterprises.

-International development assistance institutions must establish a minimum level of coordination at the national level in any country and adopt policies in support of comprehensive and coordinated approaches to assist the Informal Sector.

-Technical assistance and training schemes should be provided to national governments and non-government institutions to

improve their delivery capacities, as well as, their planning and project-generation capabilities.

-Donor Agencies should provide financial and technical support for the establishment and operation of a Regional Informal Sector Development Network which will bring together formal and informal entrepreneurs and their public and private support organizations to exchange information, technologies and to establish cooperating mechanisms among countries of the Region.

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