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**Off-Farm
Employment in
Ecuador:
Preliminary
Observations and
Recommendations**

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TABLE OF CONTENTS

Page

EXECUTIVE SUMMARY	iii
INTRODUCTION	1
"CFF-FARM" EMPLOYMENT	2
WHAT WE KNOW NOW ABOUT OFF-FARM EMPLOYMENT IN ECUADOR	3
Constraints to employment expansion	3
1. Market constraints	3
2. Macroeconomic constraints	3
3. Human resource constraints	4
4. Infrastructural constraints	5
5. Anti-competitive constraints	5
6. Demographic constraints	5
7. Political and ideological constraints	6
Weakening Constraints	11
Tasks for the Phase II team	13
I. RURAL EMPLOYMENT	13
II. SIZE OF ENTERPRISE	14
III. URBAN EMPLOYMENT	15
Recommendations on Ecuadorian counterparts	15
APPENDIX: PERSONS INTERVIEWED	16

EXECUTIVE SUMMARY

1. "Off-farm" employment has three meanings. Each is legitimate and worthy of attention. The first deals with employment of farmers on the farms of others (that is, "off" their own farms). The second centers on rural non-agricultural employment. The third is even more inclusive, covering all non-agricultural employment, including employment outside rural areas.
2. Many constraints surround the growth of off-farm employment. These include market constraints, macroeconomic constraints (uncertainty and instability, foreign exchange rate, interest rates, price policies, and wage policy), human resource constraints, infrastructural constraints, anti-competitive constraints, demographic constraints, and political and ideological constraints. Taken together the list is long and imposing.
3. Systematic knowledge of rural employment, unemployment, and underemployment is limited to census data. No other systematic surveys have been performed. The most meaningful findings generated by these data are associated with the large amount of non-agricultural employment in rural areas and the multiple sources of income earned by workers active in agriculture.
4. Systematic knowledge of urban employment, unemployment, and underemployment is limited largely to a single sample survey of Guayaquil, Quito, and Cuenca carried out in November and December 1987 by the Ministry of Labor's Instituto Nacional de Empleo (INEM), with ILO and UNDP sponsorship. The most meaningful findings of this survey are associated with the revealed importance of involuntary part-time work and sub-minimum wages (underemployment) and the lesser policy importance of open, measured unemployment.
5. Current GOE policies toward employment and development more generally are still in formation. Public and private pronouncements are sometimes contradictory. Long-time observers do not agree on central themes.
6. To weaken existing constraints on the expansion of off-farm employment deserves a two-pronged approach. Policy dialogue dealing with the macroeconomic issues is suggested. A project approach combining research and action with respect to a variety of employment-generating alternatives is also recommended.
7. A long but feasible list of specific tasks is presented as next steps for the team of consultants selected to perform the second phase of this study.

Introduction

In a low-income country, the basic issues surrounding productive employment are among the simplest and most important. To be sure, considerable analytical and managerial sophistication can be lavished on them, but consensus seems likely in connection with the following questions.

1. **What are we trying to achieve?** To the extent possible, we are trying to create conditions that augment material wealth and social welfare. Higher income and wealth permit its owners broader choices in their lives. Improved social welfare means that people can live longer and more productive lives. Effective development also allows a greater fraction of the population to share equitably in the fruits of development.

2. **Why is employment important?** The rapid growth of productive employment is important because it speaks directly to the issues addressed above. Productive employment generates output for the nation, provides personal income for the productively employed, and creates a sense of self-worth without which material advance would be meaningless.

3. **How does productive employment relate to other development strategies?** While every development strategy affects employment, many do so only indirectly. For example, development strategies have frequently emphasized increases in output and efficiency, assuming that greater employment and personal income would flow automatically. "Basic needs" approaches cut through the income-expenditure linkages to deal directly with education, sanitation, nutrition, and the like. A specific focus on productive employment, however, seeks to improve output, income, and welfare directly as noted above. It does not assume that higher GNP will necessarily raise the numbers of people working productively or that widespread income redistribution will occur spontaneously through effective fiscal policy. It does not target a single element in human life and focus exclusively on it.

Instead, considerations of employment look at how people spend their time (which is to say, their lives). An employment focus concentrates on how the material conditions of their lives might be broadly improved. And because it views personal income generation directly, it can deal with greater assurance with concerns about income equality.

All other development programs are indirectly linked with a nation's employment situation. The breadth of the linkages contains a danger as well. Considerations of employment within development frequently lack focus because every developmental variable, in the end, is involved. The biggest task for analysis and practice is to concentrate on a limited number of alterable variables within the overall context of the employment situation.

"Off-farm" employment

Three meanings. Concern with employment in Ecuador has led AID/E to commission a study of "off-farm" employment as background for its forthcoming CDSS. Under varying circumstances, policy makers have used the term "off-farm" employment to refer to at least three different phenomena. A strategy that seeks to target "the" problem of off-farm employment, as if there were only one, may therefore encounter conceptual and methodological difficulties from the outset.

(1) Off-farm employment may be viewed as employment of farmers "off" their own farms and on the farms of others. Such employment may be seasonal. It may reflect landlessness or small holdings. It may be rooted in a farmer's lack of productivity on his own lands, for any of a dozen reasons. The key element in this first form of non-farm employment is that its output continues to be agricultural. The farmer working off his own farm but on the farms of others continues to produce agricultural output in areas that are rural by definition.

(2) The second meaning of "off-farm" employment focuses on farmers who earn part of their incomes in non-agricultural activities. Farmers routinely collect, grade, store, transport and market their output, as well as growing it. Farmers and ex-farmers in rural areas also engage in a wide variety of construction, small-scale manufacturing, commerce, and service activities. The second interpretation thus concentrates on rural non-agricultural employment.

(3) A third interpretation of "off-farm" employment is considerably broader. It looks at all non-agricultural employment, both rural and urban. Because the expansion of urban employment in recent years has been most vigorous in small enterprises, the third interpretation sometimes includes an emphasis on small business.

All three interpretations are legitimate. All three are worth further exploration. The following report, while conscious of the distinction among them, nevertheless conjectures that the problem of productive employment must be considered in an integrated fashion if policy efforts aspire to be effective.

Relation to current AID/E programs. Each of AID/E's four main areas (health and family planning, agriculture and natural resources, housing, and general development) has an employment impact. If off-farm employment is to receive additional emphasis, its relation with existing programs can readily be made more explicit so that a high degree of coordination and integration among the country's programs can be achieved.

What we know now about off-farm employment in Ecuador

Constraints to employment expansion

1. Market constraints

Vigorous expansion of productive employment requires well-financed and rapid economic growth. The collapse of the oil boom mirrors Ecuador's historical experience, first with cacao and later with bananas. Oil's collapse has left the economy without a unique and symbolically identifiable engine of growth.

Slow growth in output, exemplified by Ecuador's post-oil-boom difficulties, means that personal income stagnated, per capita expenditures failed to grow, and derived demand for labor slumped. No new single source of export revenues has replaced oil. Accordingly, future economic development is likely to follow more diversified lines. Policy makers will be sensitive to the demonstrated hazards of reliance on a single source of national wealth. In turn, this implies that an effective employment generating strategy must be structural and segmented, rather than economy-wide.

2. Macroeconomic constraints

a. **Uncertainty and instability.** The uncertainty associated with political turnover leads would-be investors to take a wait-and-see attitude. Only when the tax and cost considerations surrounding new investment become clearer will private investment plans once again be activated. If the macroeconomic policy and the regulatory framework is perceived as unstable, with an indecisive government changing incentives, rules, and taxes unpredictably, private investment will be lower than in a more stable atmosphere.

b. **Foreign exchange rate.** Over-valued foreign exchange rates favor imports and discourage exports, thus chilling local job creation prospects. Historically, commercial policy has sought to offset these effects by protecting domestic industry and subsidizing some (but not all) exports. For reasons explicable in terms of vested interests, commercial policy seeks to undo what overall exchange rate policy might accomplish.

c. **Interest rates.** Real interest rates have been consistently negative; high nominal rates have been accompanied by even higher rates of inflation. While encouraging demand for loanable funds to pay for investment and other purposes (consumption, capital flight, etc.), negative real interest rates dry up savings and thus starve the banking system. The investment that would emerge from a smoothly articulated set of financial intermediaries is absent. New employment suffers accordingly.

d. **Price policies.** Policies that affect individual prices have readily predictable microeconomic consequences. An atmosphere of attempts at widespread price controls has additional macroeconomic effects. Price ceilings on basic necessities respond to pressures from urban consumers caught in an inflation. Nevertheless, price ceilings on **output**, coupled with inflationary cost increases on all **inputs** to production, discourage the expansion of production, with predictable results for employment.

e. **Labor code and wage policy.** Legislated minimum wages and an extensive set of obligatory fringe benefits raise labor costs and push workers into self-employment and the informal sector. Both economic and psychological effects are present. The proliferation of required worker benefits discourages formal employment in ways that can't be completely explained by cost considerations alone. In Ecuador, these benefits currently include the thirteenth, fourteenth, and fifteenth salaries, a bonificacion complementaria, a cost-of-living allowance, an urban transport bonus, two types of payments to the social security system, and profit sharing; in addition to requirements for accident and sickness compensation, company stores, cafeterias, primary schools for dependents, social workers, leaves for foreign study, maternity leaves, funeral leaves, work clothes allowances, and military service offset pay. After a three-month probationary period, employees can be laid off only upon payment of an "indemnization." Workers in firms of 15 or more employees have the right to organize in unions.

In some cases, these are minimal, representing political symbolism rather than economic substance. But the length of the list is imposing and thus potentially depressing to employers considering programs of expansion of formal employment.

3. **Human resource constraints**

World Bank specialists have recently calculated rates of return to formal education in Ecuador. They show that primary education generates the highest private and social returns. Presumably elementary literacy and numeracy are involved. By contrast, low rates of return to secondary and post-secondary education imply that the effectiveness of education at those levels, measured strictly in economic terms, is well below that of competing investment alternatives. The low quality of secondary and university education appears to explain these disappointing rates. In a society impressed by formal credentials, demand for secondary and university education has maintained itself, leading to visible frustration for graduates, drop-outs, and their families when they experience unexpectedly low private returns. Note that, since formal education is heavily subsidized, social returns are even less than private returns.

These results affect the potential for employment generation. If low quality education leads to low rates of economic return in this important activity, the prospects for growth of output and employment are impaired.

4. **Infrastructural constraints**

No one suggests that the present system of rural infrastructure is adequate to the task of economic development. Secondary and tertiary farm-to-market roads can create profitable possibilities for marketing agricultural products or rural manufactures. Similarly, gaps in communications networks mean that producers outside the cities have to spend more for accurate information or to struggle in its absence. Serious efforts at economically productive decentralization are hampered by current infrastructural deficiencies.

5. **Anti-competitive constraints**

Widespread impressions suggest that agricultural products are subject to monopsony and monopoly. A long chain of transactions begins with buying at the farm gate and ends with selling to ultimate retailers and then to consumers. To the popular imagination, this suggests the presence of conspiratorial and anti-competitive practices, owing to the requirements for working capital for inventories, reliable access to costly storage facilities and transportation, and accurate information. Different products are, of course, subject to different degrees of competition.

Employment creation occurs more readily in the presence of competition than in its absence. More detailed assessment of the degree of competition in major agricultural products sold domestically would suggest potential strategies. Even the credible threat of competition from the public-sector agricultural marketing agency might be enough to improve the existing situation.

6. **Demographic constraints**

While the growth rate of population has declined, the rate of growth of the labor force continues to increase and will do so into the 1990s, owing to the age distribution of the population. As young people, labor force entrants are the least experienced and the least productive workers, although their educational attainments are higher than those of persons already economically active.

Regionally these tendencies toward the rapid growth of the labor force are modified by rural-urban migration. Statistics on Ecuadorian rural-urban differentials in birth and death rates are not readily available. The best estimates suggest that about half the growth of the biggest cities results from "natural increase" (that is, births less deaths), while the other half is attributable to net urban migration. This is roughly equivalent to the experience of other Latin American countries at similar stages of development.

7. Political and ideological constraints

In the past, Ecuadorian development strategy has publicly advocated the virtues of import-substituting industrialization, while relying on revenues generated by a single traditional export commodity. This combination of policies is directly implicated in the current economic problems of the country. Implicit reluctance to diversify exports, expand the tax base, and restrain growth in public sector employment has resulted in public sector deficits (foreign and domestic), a high rate of inflation, and increasing popular agitation for reform. Emphasis on heavy industrialization has distorted the exchange rate and encouraged capital-intensive and import-intensive methods of production, at the same time that growth in productive employment was neglected. From observation, it's easy to conclude that industrialization has a deep-seated ideological appeal -- an appeal more powerful than conventional economic analysis can explain.

Micro-enterprises. The smallest firms in poor countries have recently received an unprecedented amount of attention. No longer is economic development associated only with giant firms taking advantage of alleged economies of scale, usually in capital-intensive industries patterned after those in rich countries. The reasons for the evolution of emphases are conceptually straightforward. All inputs to production are scarce, but all are not equally scarce. If physical capital and foreign exchange are relatively more scarce in poor countries than in richer ones, while labor is relatively more plentiful, then techniques of production that are labor-intensive are not only more efficient in producing output in poor countries, but also result in more immediate generation of personal income as well.

Furthermore, only a few activities in poor countries are actually marked by notable economies of scale. Steel-making, oil and chemical refining, automobile assembly, and the generation and distribution of electricity are among the activities in which large firms appropriately predominate even in low-income countries. By contrast, most wage goods (that is, goods bought by employees earning wages) in poor countries do not exhibit big economies of mass production. The unit costs of making bread, milk, beer, matches, umbrellas, textiles, garments, bicycles, and simple dwellings, for example, are not lower in large establishments than in smaller ones. When elementary cost-accounting is rigorously applied, economists and planners now recognize that small firms are attractive, both because they are economically rational and because their income generating function does not require either "trickle down" or government intervention.

As noted below, small firms are not the only vehicle by which employment generation may proceed. But it is well at the outset to recognize explicitly the economic and social appeal that small firms have within a well balanced development strategy.

Distinctions between informality and micro-enterprises. Micro-enterprises and informal economic activity are related but distinct concepts. If they are carelessly used as synonyms, analytical and policy errors can occur.

The Ecuadorian legal definition of micro-enterprises was written for the formation of the Unidad Ejecutora del Programa Nacional de Microempresas (UNEPROM) in 1986. The elements of every classifying convention are subject to discussion. Nevertheless they seem to capture the essence of micro-enterprises as they exist locally. Micro-enterprises are thus characterized as firms with:

- Only one or two managers;
- Fewer than ten (salaried) workers;
- Assets less than 100 minimum legal (monthly) salaries;
- Labor-intensive methods of production;
- Low retained earnings, making internally financed growth difficult or impossible; and
- Limited access to (formal) sources of credit.

Excluded from the concept of micro-enterprises is the self-employed worker (trabajador autonomo o trabajador por propia cuenta). This convention thus requires an "enterprise" to involve more than one person.

A working definition of the formal sector is simply that set of firms whose workers are members of the social security system. In 1982, 36 percent of urban workers were members, 9 percent of rural workers, and 23 percent of workers nationwide. If we accept this definition, the size of the informal sector, in absolute and relative terms, is large indeed.

The Ministry of Labor's Instituto Nacional del Empleo (INEM) has grappled with the conceptual question of informality. In connection with its urban employment surveys, it notes that the informal urban sector is a set of establishments and not a set of persons. Nevertheless, the following convention can be used to calculate the number of people involved in the informal urban sector:

Self-employed (own-account) workers, less self-employed professionals and technicians,

Plus unpaid family workers;

Plus owners of micro-enterprises;

Plus employees in micro-enterprises; and

Less domestic servants in any occupational category.

This convention accords with common impressions and can be quantified in the INEM/ILO survey of urban employment and unemployment carried out in Nov.-Dec. 1987 in Quito, Guayaquil, and Cuenca.

Rural database. At present, the only reliable source of data about rural employment and its characteristics (demographic, social, economic) are the country's population censuses. Morris Whitaker, an AID consultant, has exhaustively analyzed the censuses of 1950, 1962, 1974, and 1982. Chapters in a longer work currently in draft include, among others, "Population: Characteristics and Indicators" and "Rural and Urban Distribution of the Economically Active Population." The latter contains good data about rural participation in non-agricultural activities.

Whitaker's most arresting and controversial conclusion is his finding of a convergence between urban and rural incomes. His calculations lead him to conclude that the ratio of rural per capita incomes to urban per capita incomes are growing. This directly contradicts the popular notion that rural regions stagnate at subsistence levels while urban ones grow and that per capita incomes follow the same trajectory. Simply on a Ricardian basis, the low (or negative) rates of population growth in the countryside, coupled with the growing negative externalities of urban congestion, provide a post hoc explanation. For technical reasons beyond the scope of this report, the conclusion seems even more robust than it appears in the Whitaker paper.

At the same time, he uses the assumptions of rural-urban equality in productive techniques to derive conclusions about the absolute size of rural incomes and thus about rural poverty. But in urban areas, the capital intensity, labor productivity, and incomes are likely to be higher in at least manufacturing, construction, commerce, and perhaps services. Thus the conclusions about absolute poverty levels are suspect.

In short, the convergence hypothesis dealing with relative incomes seems upheld (or even strengthened), while conclusions about absolute rural poverty depend crucially on the strong assumption that rural and urban production functions are the same.

Whitaker also concludes that the census understates inter-censal inter-provincial migration by a significant fraction. Net migration may be three times that implied by census figures.

During the period 1982-1990, Whitaker projects the population growth rate at 2.86%/year; 1990-95, 2.69; 1995-2000, 2.51. These rates can be compared with projections of economically active population provided by the Inter-american Development Bank: 1980-1990, 3.03%/year, 1990-2000, 2.83. While both population growth and labor force growth are slowing, labor force growth exceeds that of the population, as a result of the changing age structure of the population.

Refined census data show Ecuador with 3.2 million people in 1950, of which only 28.5 percent were urban. By 1988, Whitaker estimates that more than half (55 percent) of the country's 10.2 million people live in urban zones. "Urban" is defined politically rather than demographically (minimum size of agglomeration) or functionally ("urban" characteristics). Despite the speed of urbanization, the absolute increase of rural people is still remarkable. In 1950 there were 2.3 million rural Ecuadorians; in 1988, 4.7 million, implying an absolute increase of 2.4 million.

With respect to internal migration, Whitaker finds the same high volume of movement observed elsewhere. Gross migration in all directions exceeds net migratory flows by a multiple. This complicates the conclusions that might more readily be drawn if the gross and net figures were more similar.

Whitaker finds that the economically active population in agriculture declined considerably between 1962 and 1982, while a study by the Ecuadorian economist Jaime Moncayo shows a slight increase. The reasons for the difference are undetermined and are of sufficient magnitude to merit further attention.

Urban database. Ecuador, alone in the Andean region, lacks a periodic survey of labor force, employment, and unemployment. It is symptomatic of the low priority given to statistical analysis that the oil revenues even during the 1970s were never allocated for such a statistical and analytical instrument. Only the present crisis has stimulated a survey, sponsored with technical cooperation from the United Nations Development Program and the International Labor Office.

Two documents about the Ecuadorian survey are in our files:

1. Questionnaire used in the survey
2. Technical manual of definitions

INEM's employment survey was taken in November and December 1987 in Quito, Guayaquil, and Cuenca. In Quito and Guayaquil, the sample size was 2,500 households each, while in Cuenca 950 households were surveyed. A future survey will extend to 63(!) secondary cities. Results of that survey will be statistically significant for the seven regions into which these cities fall.

Until now, CONADE has provided the existing annual figures for urban unemployment rates. Rodolfo Pisoni, principal technical adviser for the INEM study, said he'd never received a satisfactory explanation of CONADE's methods to calculate unemployment. Since CONADE doesn't use a sample survey, Pisoni conjectured that they begin with figures for growth in output and coefficients of the relation between output and employment. The employment thus calculated is compared with independent projections of the size of the labor force. Open unemployment is the difference between these two figures.

Of course, that method has many methodological faults. It confuses average with marginal figures. It uses fixed coefficients in a period in which production techniques and relative prices were changing quickly. Because it is calculated as a residual, it also incorporates all errors and omissions. Thus the trend of growing urban unemployment that it reveals could easily be a statistical artifact. In short, the measurement is useful neither as an absolute indicator of urban unemployment nor as a measure of comparisons over time.

In any event, CONADE's figures (12%) are much higher than INEM's (7%) for the same period. The interpretation of INEM's survey results must be handled with care, since there has only been a single survey using these methods. In particular, because it was taken during the weeks before Christmas, it may exaggerate the year-round employment status of the population.

The INEM survey measures two kinds of underemployment. The first kind ("visible") deals with persons involuntarily working part-time, while the second ("invisible") concerns itself with the full-time workers who earn less than the legal minimum salary. The combination sums to 40 percent of the labor force calculated on the basis of full-time equivalent employment.

Labor market segmentation between the modern (formal) sector and the traditional (informal) sector was also explored by the survey. The formal sector composes about 65 percent of the urban economy, with the informal sector making up the rest. The definition of informality is complex and carefully drawn, as noted above in the section on informality and micro-enterprises. It summarizes the main characteristics associated with the broad notion of informality, and thus its presence in the INEM survey is potentially useful.

Interpreting urban unemployment. Specialists in the interpretation of statistics on measured unemployment in developing countries have arrived at a potentially controversial consensus. (I am one of them and I want to be associated with the following views.) There is a sense in which open, measured unemployment automatically rises as development and urbanization proceed. At the lowest levels of income, few are unemployed. Everyone does something, whether through self-employment or through wage employment. Productivity and wages are near subsistence. Without past savings or unemployment compensation, poor people cannot afford to be unemployed. Surveys that measure the degree of open unemployment find very little of it. Only at higher levels of income and urbanization do increasing occupational specialization, higher family earnings, greater savings, and embryonic social welfare institutions permit the "luxury" of open unemployment.

The INEM survey's figures correspond with this framework. Family heads have an unemployment rate of only 2 percent, while non-heads have a 10-11 percent rate. Open unemployment is composed largely of secondary workers (for example, female non-heads of household, students who live with their families) who can afford to use periods of unemployment to extend their search for suitable work. If low-income heads of household become unemployed, they very quickly take any job offered or enter into self-employment. Thus the measured rate of open unemployment does not have the same interpretation that might be applied in an industrialized country during a big depression.

In periods marked by employment problems and widespread economic distress, emergency employment programs are frequently suggested. They have been implemented in Chile, Peru, and other Latin American countries, as well as the U.S. It is worth noting that they may actually raise the measured rate of unemployment. Persons employed in emergency programs in other Latin American countries have typically come from the ranks of the formerly inactive, rather than from the openly

unemployed. Emergency employment programs usually have little to offer the openly unemployed, since the latter are seeking other kinds of work. Emergency employment programs raise the income of the poorest and thus act as a quick program of income transfers, but they do not reduce the measured rate of unemployment. The point deserves emphasis because politicians and others might plausibly expect the unemployment rate to fall if a big emergency employment program were started. They would be disappointed and politically embarrassed if the rate failed to fall.

Current GOE development strategy. To speak of Ecuador's current development strategy as if it were complete, coherent, and fixed would clearly be superficial. Long-time observers find themselves in disagreement about proposed policy thrusts. On the economic side, some official statements by spokesmen for the new government suggest an emphasis on increased public-sector participation in the economy, greater central planning efforts, and a reversion to the goal of income-substituting industrialization. Behind closed doors, government officials have reportedly endorsed agricultural development and export promotion.

In a low-income country, resources are especially scarce. Ecuador confronts severe problems of fiscal budget deficits, foreign debt, inflation, social discontent. Accordingly, not everything can be done at once. Economic policy cannot emphasize both agriculture and industry simultaneously. It may be politically attractive to assert that import substitution and export promotion are not contradictory, but in fact the policies necessary to implement them are likely to be mutually exclusive. In this context, the role of policy dialogue in arriving at internally consistent development initiatives is likely to gain importance.

With respect to employment, a confusion between unemployment and underemployment seems prominent. Diatribes against "unemployment" are a daily staple, when the problem of output and income, as already noted, appears to be more deeply rooted in underemployment.

Weakening constraints

Two methods to weaken the constraints that limit the expansion of off-farm employment can be explored. On a broad scale, continuing policy dialogue can help to create an environment in which development activities are most likely to be successful. And more narrowly, attacking the employment problem with particular projects may provide a setting for visible and effective action.

It is well to be clear at the outset about the limitations of any recommended strategy, however. In particular, no plan of action can be unequivocally shown to be optimal. To promise such a plan would be equivalent to fostering a delusion. A cost-benefit survey of all the attractive potential projects that have employment-generating aspects, coupled with an analysis of the manifold policy areas in which dialogue could be conducted, with the intention of ensuring that only the best combination is pursued -- that's a task that may be methodologically impossible and one that is certainly beyond the scope of effort specified for the present project.

Policy dialogue. Briefly stated, policy dialogue with appropriate Ecuadorian authorities can be conducted in all the areas mentioned above in the section dealing with constraints. Thus advocacy of policies that encourage rapid growth, removal of uncertainty, market-oriented foreign exchange rates, positive real interest rates, price policies associated with costs and markets, wage policies that encourage the growth and entry into the formal sector of small firms, higher quality in secondary and university education, encouragement of competition in marketing, a fall in the birth rate, and a softening of the anachronistic attachment to import substituting industrialization would all be steps in the right direction. An improvement in any one of these areas can potentially do more good than the typical multi-million dollar project.

USAID is not the only international agency concerned with policy dialogues. The multilateral international agencies have a long record of attention to these matters, and they're prepared to extend "structural adjustment loans" on the basis of "conditionality" directly and contractually related to policy changes. In these circumstances, AID's role is necessarily more subtle but no less important. In particular, AID's comparative advantage appears to lie in its extensive hands-on experience by a resident staff. This experience gives the agency knowledge that other international organizations may lack. Thus, for example, AID doesn't have to guess about what interest rates might be appropriate on loans to small businesses, since its officers have been active in this area.

Project possibilities. A bounded set of potential projects should be explored. Among the candidate possibilities is the improvement of economic conditions surrounding micro-enterprises in Ecuador's secondary cities. Some combination of loan funds, training, and market research suggest themselves.

The rapid growth of micro-enterprises in Ecuador and elsewhere in Latin America has been demonstrated. In an economic environment where larger firms have frequently been hobbled, small businesses have shown surprising vigor. Ideologically their growth can be viewed as evidence of penny capitalism's indomitable energy. More analytically, the ease of entry, labor-intensive techniques, absence of formal managerial structure, and low costs, coupled with the simple need to survive, are also consistent with the observed growth.

At the same time, concern with agricultural stagnation and urban migration has focused attention on the growth of the biggest cities. While urban migration may improve the life of the typical migrant, he or she doesn't have to bear the social costs imposed on the rest of urban society by the congestion and pollution that accompany rapid city growth. No one suggests that the present rate of growth of Ecuador's largest cities is desirable. Therefore an emphasis on off-farm activities concentrated in the secondary cities appears appropriate.

These are not the only avenues to development, however. A review of productive employment in Ecuador that looked only at the smallest firms in secondary cities would be unnecessarily narrow. Accordingly, the research team may wish as well to review free trade zones, agribusiness, promotion of non-traditional exports, development of small and medium enterprises (as well as micro-enterprises),

and industrial re-activation. The list is long and challenging, but adequate formulation of the CDSS requires the review of more than a single strategy.

In the four- or five-year time horizon used by the CDSS, a research component should also be considered. Specifically, the extension of the Ministry of Labor/INEM/ILO employment survey to Ecuador's secondary cities could fill an information vacuum about unemployment, underemployment, and incomes that now exists. The professionalism of the survey as conducted in the three largest cities augurs well for an extension.

Tasks for the Phase II team

In connection with the present contract, DAI proposes to field three specialists during a second phase to provide a higher degree of focus and more in-country detail to the framework outlined above. The team will be supplemented by Ecuadorian counterparts. It might be noted that the proposed level of effort of Phase II is from six to ten times that of Phase I, giving some promise that an interesting and useful set of tasks can indeed be completed.

The list that follows draws directly on the foregoing outline. I have tried to be quite careful to avoid specifying an excessive or infeasible list. Indeed, Mission personnel may wish to extend the list to cover other areas or other tasks within these areas. Nevertheless, if we emphasize next steps, the following ones seem to be the most appropriate, given the state of present knowledge and the aims that have been mentioned above.

I. Rural Employment

1. Review the multiple sources of income of agricultural workers. Most earn income from both agricultural and off-farm activities.
2. Estimate the extent to which increases in agricultural productivity actually lead to displacement of agricultural labor. Note that the relation between employment and productivity change involves consideration of elasticity of demand (domestic and foreign) for output, elasticity of factor substitution, and questions of managerial effectiveness (or "X-efficiency"). The conclusion that improvement in farm productivity automatically leads to expulsion of workers from agriculture involves a series of implicit assumptions, each of which ought to be evaluated in the Ecuadorian context. The danger of the conventional conclusion relating improved productivity and farm employment is that the possibility of displacement of workers may actually inhibit the adoption of policy measures associated with agrarian development.
3. Estimate the effect on employment of alleged anti-competitive practices in agricultural marketing. Concentrate on the foodstuffs with the highest weights in the consumer price index.

* * * *

Much of the off-farm economic activity in rural zones is agriculturally related or generated. Information relative to the following issues (Tasks 4, 5, and 6) in agricultural development also shed light on non-agricultural employment generation in rural areas.

4. Review public policy on exported and exportable crops, to determine their effects on employment. Examples: foreign exchange rates applicable to agricultural exports, price ceilings, regulations involving imported inputs to agriculture (seeds, fertilizers, pesticides and herbicides, agricultural machinery), credit availability and interest rates for agriculture with special emphasis on small farmers.
5. Trace the employment-generating possibilities associated with targeted expansions in output of non-traditional agricultural exports. These remain only a small fraction of agricultural exports, but are growing rapidly and represent prominent examples of success in the recent past. They include pineapples, melons, other fruits and vegetables, cut flowers, and shrimp. To what extent are these non-traditional exports subject to prohibitions, quotas, or licenses?
6. Resolve the differences between calculations by Whitaker and Moncayo on rates of growth of the economically active population in agriculture.

II. Size of Enterprise

1. Ascertain the extent to which Ecuadorian evidence allows conclusions to be drawn about the relationship between the size of enterprise and employment creation. In particular, focus on capital requirements per worker and incomes in enterprises of different size. Seek to draw distinctions between micro-enterprises, as defined above, small enterprises (11-50 workers), medium-sized enterprises (51 - 100 workers) and large enterprises. One point of departure will be INSOTEC's experience with small firms in four coastal cities.
2. In addition to questions of economic growth associated with firm size, review as well the evidence on social improvement. In particular, small enterprises are sometimes advocated as vehicles whereby egalitarian income distribution is most directly stimulated. Does Ecuadorian experience appear to confirm such a conjecture?
3. Use the INEM data to explore the linkages among micro and small firms, informality, underemployment, and income.
4. Review the experiences of the Fundacion Eugenio Espejo and the Federacion Economica de Desarrollo (FED) in conducting training and credit programs in small and micro enterprises.

III. Urban Employment

1. Using the INEM/ILO urban employment survey of 1987, generate tables and analysis that relate unemployment and underemployment to age, sex, educational attainment, and skill level.
2. Ascertain the nature of the barriers to progress of the free trade zone at Esmeraldas, sponsored by CENDES. Use that experience to make recommendations on the viability of the extension of free trade zones to other cities.
3. Track down and follow up on an AID/E study of employment in secondary cities, produced about five years ago in connection with a concern for housing in those cities. Review the study for its implications for employment.
4. Contact CONADE to ascertain the nature of its involvement with the ILO in connection with past studies of employment.
5. Review the employment-generating implications of AID/E's four major programs.
6. Resolve the apparent contradiction between the conclusions on the speed of urban migration suggested by Whitaker and those of the censuses.

Recommendations on Ecuadorian counterparts

1. In the INEM, computer analyst Vicente Merino and research analyst Javier Davalos could be asked to coordinate some of the tasks mentioned in connection INEM's employment survey.
2. Pablo Lucio Paredes of the consulting firm Coloma and Paredes has a secure grasp of the macro-economic constraints facing the country.
3. INSOTEC's Fernando Fernandez and his team, including sociologist Pablo Samaniego Ponce, have amassed a wealth of experience and data about their AID-financed project in four coastal cities.
4. The Ministry of Agriculture's economist Carlos Luzuriaga has made extensive studies of conditions surrounding production and income distribution in Ecuadorian agriculture.

Each of these institutions and researchers would be valuable counterparts to the Phase II team.

Appendix

Persons interviewed

1. In Washington, D.C.:

Inter-American Development Bank --

Francisco Thoumi and the members of the team doing the Ecuadorian economic survey beginning in mid-October 1988

USAID/W --

Bob Young
Clarence Zuvekas
Marvin Schwartz
James Schill
Don Kennedy

World Bank --

William Tyler, chief economist for Ecuador
Bernardo Kugler, Human Resources
Mauricio Carrizosa, Manufacturing, Finance
Joel Bergsmann, International Finance Corporation

2. In Quito:

Officials in the AID mission

Morris Whitaker, AID subcontractor
Duty Greene, AID subcontractor
Richard Blankfeld, Robert R. Nathan consultants
Julia Banderas, labor market specialist, Instituto de Altos Estudios Nacion ales
Alberto Dahik, Conservative Deputy, former Finance Minister
Rodolfo Pisoni, ILO adviser to the Instituto de Empleo Nacional (INEM)
Pablo Lucio Paredes, general manager, Coloma y Paredes (private consulting firm)
Enrique Espinel Rivadeneyra, Gerente Tecnico, CENDES
Fernando Fernandez, Director of the Centro de Desarrollo de la Pequena and
Mediana Industria (CEPEDI) in the Instituto de Investigaciones Socio- Econom-
icas y Tecnologicas (INSOTEC)
Pablo Samaniego Ponce, research sociologist, INSOTEC
Raul Baca Cargo, Minister of Social Welfare