



**BUILDING
CONSTITUENCIES
FOR ECONOMIC
CHANGE:**
Report on the
International Conference
on the Informal Sector

Sponsored by
The Center for
International Private Enterprise
and the
United States Agency for
International Development

Held at the U.S. Chamber of Commerce
Washington, D.C.

October 26-27, 1987

Edited by John D. Sullivan, CIPE

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October 20, 1987

Mr. William T. Archey
Vice President
Center for International Private Enterprise
Washington, DC 20062

Dear Mr. Archey:

I have received with interest the information which you sent me regarding the conference on the Informal Sector, sponsored by the Center for International Private Enterprise, an affiliate of the U.S. Chamber of Commerce, and the U.S. Agency for International Development, on 26 and 27 October, 1987. This is a subject of considerable importance in the today's world. Indeed, it is one to which increasing attention is being devoted at various levels in the United Nations system. The General Assembly, at its last session, approved a resolution regarding the role of indigenous entrepreneurs in economic development which is germane to the issue and which is to be followed up on in the future.

I take note, in particular, of the fact that my countryman, Mr. Hernando de Soto will be playing a prominent role in this Conference. As it happens, he is a member of the Committee for Development Planning, a high-level United Nations advisory panel. I am, of course, personally familiar with the work of Mr. de Soto, which I have long admired. His recent work, "El Otro Sendero," is a brilliant and exhaustive study of the economic and social problems of developing countries.

I wish you every success in your deliberations.

Yours sincerely,



Javier Perez de Cuellar
The Secretary-General
United Nations

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Preface

In October 1987, the Center for International Private Enterprise (CIPE), an affiliate of the U.S. Chamber of Commerce, and the U.S. Agency for International Development (A.I.D.) sponsored an international conference in Washington that brought together 250 business, political and academic leaders from 35 countries to examine a fresh approach to issues of economic growth and development.

The theme of the conference was the political and economic clout that the entrepreneurs of the informal sector can wield in the developing world today. Throughout the Third World, this informal sector comprises a vast underground market operating independently of governmental authority. It is usually treated as a problem of unemployed labor. Governments have attempted at various times to solve this problem through job creation schemes, formation of public enterprises, increased regulation of business, import substitution or benign neglect.

CIPE's purpose in publishing the conference proceedings is to reach a widespread international audience while providing the conference delegates with a written record of the discussions. It is our hope that decision-makers in the private and public sectors will find the presentations provocative and will seek to implement the programs and policy recommendations described herein, as may be appropriate to their countries. To this end, a summary menu of policy recommendations is provided in the epilogue.

"Building Constituencies for Economic Change" is part of CIPE's overall support for market-oriented approaches to economic growth and development. As such, the informal sector conference is but one in a series of CIPE sponsored initiatives to encourage the widespread adoption of programs and policies benefiting the entrepreneurs of the informal sector, the overall business community and society at large. Several follow-up activities are in the planning stage. For instance, CIPE plans to issue periodic reports, in newsletter format, as a forum for the exchange of new ideas and program approaches. Part of the process of producing the newsletter will involve surveying those attending the informal sector conference and others participating in similar programs. In addition to publishing information, CIPE will continue to provide financial support for private sector initiatives throughout the developing world.

Today, a revolution is occurring in development thinking—a revolution that comes from within the developing world itself. By looking at old problems in new ways, a group of Third World scholars and business people are now looking to the informal sector as a source of economic growth, rather than as a drag on modernization.

Studies in various countries demonstrate that between 30 percent and 60 percent of the work force and Gross Domestic Product (GDP) are in the informal or underground market. These informals are not part of the criminal class involved in drugs or other illicit activities. Rather, the informals are entrepreneurs who produce legitimate products without proper permits and legal status because they cannot cope with the red tape and other constraints preventing entry into the legal economy. As a result, they have formed a market system separate from the legal economy. Economic progress, however, requires both economic and political reform to remove the root causes of these dual economies.

In a capsule, the thesis put forth during the conference is this: the developing world is now at the threshold of the entrepreneurial revolution experienced in the developed world three centuries ago.

The idea for a conference on the informal sector approach grew out of the programs supported by the Center for International Private Enterprise in Latin America and Africa. However, it is the groundbreaking work of Hernando de Soto's Institute for Liberty and Democracy in Peru that forms the basis for the conceptual breakthroughs reported in the body of the report. De Soto's book, El otro sendero: la revolucion informal (The Other Shining Path: The Informal Revolution), first appeared in November 1986. Since that time, over 100,000 copies have been sold throughout Latin America. This is truly extraordinary for a public policy work.

This report summarizes the discussions from the day-and-a-half conference. Speakers reported on ongoing programs of research and policy advocacy being pursued in countries as diverse as Peru, Argentina, Venezuela, Paraguay, Brazil, South Africa, Tunisia and Kenya. While these programs are in different stages of development, Latin America being the most advanced and Africa just beginning, they share a common foundation. They all believe that the day of government centered development has passed—due to its obvious failure--and that market-oriented approaches are far more likely to achieve the goals of economic growth and human welfare.

CIPE and A.I.D. have a joint interest in the informal sector approach and its extension within Latin America and to other regions of the developing world. Both have supported the Institute for Liberty and Democracy over the last four years and both seek to encourage other peoples and countries to consider the market-oriented path to development.

The U.S. Chamber established CIPE in 1983 as an operating foundation to support market-oriented approaches to economic growth and democratic development in the the Third World. Over the last four years, CIPE has supported 66 programs in 28 developing countries, as well as a variety of international programs such as the Informal Sector Conference and the Journal of Economic Growth. The Journal is published by the National Chamber Foundation in English, Spanish and French, with a distribution base of 8,000 opinion leaders worldwide.

CIPE receives its funding from the National Endowment for Democracy through annual Congressional appropriations.

I would like to express my thanks to all of those who attended the Informal Sector Conference, many of whom traveled thousands of miles to participate. Their willingness to do so is testimony to the growing appeal of market economics and private enterprise as the most effective path to economic growth and human progress.

William T. Archey
Vice President

June 1988

PART I
OPENING ADDRESSES

Dr. Richard L. Leshner
President
U.S. Chamber of Commerce

On behalf of the officers and directors of the Center for International Private Enterprise and on behalf of the 180,000 companies that make up the United States Chamber of Commerce along with some 2,800 state and local chambers and 1,300 trade and professional associations, it is a great pleasure to welcome you to this International Conference on the Informal Sector. We are very pleased that the U.S. Agency for International Development is a cosponsor of this conference.

We've always believed that it's vital for the private sector and government to work together in all countries around the world in pursuit of sound economic policy. It is essential that business and government meet together to exchange views.

The private sector relies upon the government to create the legal and policy parameters within which the economy must function. At the same time, it is very important for governments all around the world to realize that business people, operating within a competitive economy, create the wealth and jobs that provide for human progress.

Over the last six or seven years, there has been a global change in attitudes regarding economics. People are coming to realize that private enterprise and individual initiative are the motivating forces that create economic progress. That message is gaining credence in all corners of the globe, somewhat belatedly, I might add.

To illustrate, I would like to read a quote from an article recently published in our Journal of Economic Growth.

We need to permit companies and organizations to sell freely; to buy and borrow from their reserves so as to create a powerful and vibrant goods market; to invest their enormous but idle resources; to unleash in practice, not just in words, economic initiative in the country. In place of fruitless efforts at central planning of our entire industrial production, we should introduce contracts between supplier and consumer.

Now it may come as a surprise to you that this passage is from an article by Nikolay Shmelyov, an economist with the

Soviet Union's U.S.-Canada Institute in Moscow. The remarkable thing is that the article was first published in Novy Mir, a prominent journal in the Soviet Union which often serves as an outlet for semi-official ideas that the government wants to try out.

Now, neither the Soviet Union nor the Peoples Republic of China are going to abandon socialism in the near future. But it is very clear that both governments are coming to realize that market-oriented principles form the basis of productive human enterprise.

The conference that we are engaged in today is part of the growing worldwide interest in private enterprise. You will hear from a number of distinguished speakers about the concept of the informal sector or the parallel market.

Now, this is not a new phenomenon. Underground economies have been around for a long time. Traditionally, the informal sector has been seen as a substitute for employment in the mainstream economy. In many cases, government policy was aimed at moving people out of the informal sector into jobs. All too often, it was thought that the best way to do this was to create government-owned firms to soak up excess unemployment or to control imports to allow domestic firms to grow. The result, however, was a decline in growth in the formal sector and an expansion of the informal sector.

Thanks to the work of Hernando de Soto, we now have a fresh approach to this entire issue. Working in Peru with his colleagues from the Institute for Liberty and Democracy, de Soto has published a book that has shaken the status quo in the Americas. I'm sure that it will have the same effect throughout the world once it is translated into other languages.

As with most fundamental discoveries, the genius of Hernando de Soto's work comes from looking at an old problem in new ways. The basic question the researchers at the Institute for Liberty and Democracy asked was, "Why does the informal sector exist?"

Now, you have all read or heard something about

de Soto's famous experiment. Using a team of researchers and economists, the Institute simulated the formation and legal registration of a small firm, actually going through all the steps needed to comply with the various government regulations to obtain all the necessary licenses and permits. It took the team 289 days, working six hours a day, to register the firm legally in Lima, Peru. When the same simulation was repeated in Tampa, Florida, it took three-and-one-half hours.

Working from this very simple illustration, de Soto and his colleagues have spent the last five years demonstrating that Peru's economy is not based on market principles. The informal or extra-legal economy, however, has spontaneously created its own form of market economy. One important lesson that can be learned from the people that make up the informal sector is that market economics is not only for the developed world. As the speakers participating in this conference will show, informal entrepreneurs are found in Argentina, South Africa, Tunisia, and many other countries around the world.

This conference will help put an end to the belief that people in the developing world are not sophisticated enough to operate a market system. This is a belief that has led many countries astray, resulting in an excess of government planning and control. The informal sector's story also shows that open

government is essential for economic growth.

Over the last several years, there have been a number of transitions to democracy that parallel the growing interest in market economics. These two trends, market economics and democratic development, are closely bound together.

Later on today, there will be a panel on building grass-roots constituencies for economic change. The speakers will review the types of programs that they have developed to advocate policy change on behalf of the entrepreneurs in the informal sector. That is the real meaning of democracy. People must be allowed to participate in government policy and must be free to criticize or support decisions, not just cast votes in occasional elections.

The group assembled for this conference is one of the most diverse and prominent ever assembled in the U.S. Chamber's Hall of Flags. There are Cabinet officers, senior government representatives, business leaders and scholars from 35 countries present. Your interest and your willingness to travel from all parts of the world are appreciated.

Again, I welcome you, and I thank you for your contributions to this subject, today and tomorrow and in the months ahead.

Dr. Richard E. Bissell
Assistant Administrator
U.S. Agency for International Development

It's a pleasure to see so many people gathered together to discuss a subject of this importance. I just returned from a week's visit to Jamaica and Haiti, where I had an opportunity to talk to people involved in the informal sector as well as in other issues of economic growth. Looking in from the field, this subject seems just as important as it does from here in Washington.

A.I.D. is very pleased to be able to cosponsor this conference on the informal sector with the Center for International Private Enterprise. At A.I.D. we're very interested in private enterprise development. In many countries, that means learning about and working with the informal sector. Just last week, A.I.D. had a conference here in Washington much like this one but whose audience consisted primarily of A.I.D. policy-makers.

On that occasion, we were fortunate to have Hernando de Soto present. He is responsible, frankly, for much of the discussion of the informal sector because of his pioneering work which came from El otro sendero. A.I.D. has been involved in his work for some time.

We hope to learn much in the next few days from Hernando, as well as from the other panelists. Just as important, I want to thank all of you in the audience for coming, in many cases, thousands of miles to be here for this meeting. Certainly, with this kind of interest, I am convinced that we're seeing the beginning of a new way of looking at economic growth. We have now gotten to where we ought to have started - with the ingenuity and enterprise of free people. Today, we recognize that countries don't develop their people but that people develop their countries.

We have certainly been aware of the adverse consequences of the mercantilist economy that was described by Hernando de Soto in his work over the last number of years. A.I.D.'s private enterprise policy is to build up and rely on the indigenous private sector. But it cautions that A.I.D.'s promotion of free markets and the private sector should not be

confused with monopoly enterprises, oligarchy or crony capitalism, which have little to do with the free market. This policy is as much a challenge to limited over-regulated capitalism as it is to statist economies. Both limited capitalism and statism have squelched the ingenuity and enterprise of people in too many developing countries.

Economies suffer, and people pay the toll. Prior to World War II, for instance, Argentina was the world's seventh most prosperous nation in per capita GNP. Today it is fortieth. Government regulations are so onerous that they have resulted in an enormous informal sector.

Last July, Maria Eugenia Estensorro of the Institute for Contemporary Studies in Buenos Aires reacted to the informal sector issue in Argentina in an article in the New York Times. I'd like to quote her closing statement:

"The informal economy is a symptom of Argentina's economic woes, not a solution to them. Its presence suggests that growth will begin to recover when people begin to believe that the state is serving rather than robbing them."

It is easy to say that changing government policies is the solution. But we need more than that simple general answer. We need to know which government policies are wrong, and, in fact, these may differ from one country to another. What's more, we need to know concretely why a given policy is wrong and what its bad effects are.

More difficult is the question of how to change policies against the vested interests of an entrenched elite. This will be extremely valuable to A.I.D. in policy discussions that we have continuously with other governments.

Again, I appreciate very much that all of you are here. I know that this is taking valuable time of yours and I look forward to participating in the discussions over the next two days.

PART II

THE INFORMAL SECTOR: ITS REAL AND POTENTIAL ECONOMIC CLOUT

- Moderator:* Douglass North, Washington University
- Peru:* Hernando de Soto, Institute for Liberty and Democracy
- Argentina:* Marcos Victorica, Institute for Contemporary Studies
- Discussant:* Robert Litan, The Brookings Institution

The first panel set the stage for the conference by describing the conceptual breakthroughs leading to a market-oriented treatment of the causes of informality. Douglass North of Washington University in St. Louis, Missouri, introduced the subject and acted as moderator for the panel discussion. North is an economic historian whose seminal work, The Rise of the Western World: A New Economic History (Cambridge University Press, 1973), has done much to stimulate new thinking in the entire economics profession about the causes and conditions necessary for sustained economic growth based on his analysis of the historical development of market institutions in Western Europe since the 16th century.

Douglass North

This is a conference about institutions, about the costs of transacting and about economic growth.¹

When I began to become seriously concerned about long-run economic change, I found that the tools of economics gave very few clues to help understand why some countries had prospered over time and others had not. These economics tools also give very few clues to help understand why there is such an enormous disparity between the developed world and the Third World and why this disparity doesn't seem to be disappearing in any fashion.

Now there's nothing in economics that gives you a clue to that because economics has been a world in which all of the institutions exist, but exist at no cost. It is a frictionless society or, to use the terms that I use, it is a world of zero costs of transacting.

Adam Smith would have turned over in his grave at this idea because long ago he pointed out that the gains from trade arise because of specialization and the division of labor and that you capture these by engaging in efficient organization. Efficient organization is the key to economic growth.

Institutions matter not only because they determine the costs of transacting at a moment in time; they also determine the path of change over time. It is complicated to get efficient markets; it is not a simple phenomena. What is really wanted are: (a) adaptively efficient institutions that maximize the range of choices people have in being able to enter markets and in being able to engage in diverse economic activity; and (b) institutions that punish the losers by getting them out of the market.

This panel will give us an insight into the crucial initial questions: why it is so costly to conduct economic and business transactions and how the informal sector has dealt with this issue.

Hernando de Soto

Hernando de Soto is president of the Institute for Liberty and Democracy in Lima, Peru. His major work, El otro sendero: la revolucion informal (The Other Path: The Informal Revolution) (Editorial El Barranco, 1986), has become a best seller in countries throughout Latin America, with over 100,000 copies sold. De Soto has a master's degree from the Institute for Advanced Studies in Geneva. He has been an economist with the General Trade and Tariff Agreement (GATT), managing director of an engineering firm in Switzerland, owner of several firms in Peru and a director of the Peruvian Central Reserve Bank.

The way this all started out for me personally is that after spending a long time abroad in Western Europe, I returned to Peru some eight years ago. I asked myself why it was that others were so wealthy and we were so poor. One of the things that had always shocked me in European and U.S. universities was that the first in the class could easily have been a Filipino, a Pakistani, a Peruvian or a Mexican. Why is it that when we went back home, we went to countries that had different levels of wealth? With this state of mind, we started the Institute for Liberty and Democracy. We wanted to find out why Peru was so poor when the population looked just as prepared for development as any other.

The usual reason given in my country is that the formulas which provided wealth and prosperity for the West are not culturally or ethnically applicable. The whole Inca past and the Spanish tradition are ones that cannot be wed with private enterprise and individual initiative.

The second reason given was political. The problem is that in Latin America, capitalism is peripheral capitalism. It is one that takes place away from the center. Transnationalization of capital, monopolization of technology, and unfair terms of trade make it impossible for capitalism, free enterprise and individual initiative to work. Exploitation is unavoidable.

Well, we were not convinced by these arguments and were very much inspired by Douglass North's analysis. That is, non-economic factors such as legal institutions may be more responsible for economic growth than economic factors. In that connection, the law was one of the major differences between Europe and Latin America.

The interesting thing about the informal sector was that over 50 percent of the population had refused to join the legal institutions of the country. By studying the informal sector, we could discover what was wrong with the institutions. The informals might provide leads that were not obtainable in any other way.

The ILD's research found something called the "long frontier." If 50 percent of the population was operating illegally that meant that the formal sector knew about it. There was no way that this could just take place underground. Somewhere along the bureaucratic line, someone in the Ministry of Housing, in the Ministry of Commerce and in other parts of the government had contact with the informals. For ideological, humanitarian or philosophical reasons, or simply due to corruption, these officials were allowing the informals to survive.

By tracing the informals over three years, we were able to meet all of the most important informal entrepreneurs in Lima. Through them, we were able to develop the research and come out with the following results.

- 47 percent of total construction in Lima was outside of the law, with a value of \$8.4 billion as a result of direct investment by the informal people in their own homes. This compared with \$179 million in government housing programs.
- 95 percent of all public transportation was informal, amounting to a \$1 billion industry when repair shops and spare parts are added.
- 90,000 street vendors operated in Lima.
- 331 markets had been built in Lima: 57 by the government and 274 informally by former street vendors. Today, of every 13 markets being built in Lima, 12 are built informally.

The macroeconomic analysis found that 61.2 percent of the manhours worked in Peru were worked illegally or informally, accounting for close to 40 percent of GDP.

One of the complaints about the informal sector is, of course, that it does not pay taxes. However, when we calculated how much tax was paid by the formal, as opposed to the informal, sector, we found that the informal sector gave more revenue to government than the formal sector. For example, just about half of the taxes in Peru come from the taxes on gasoline. Since the informal sector is 95 percent of public transport, it contributes significantly through the gasoline tax. We also found out that there is such a thing as inflation tax. Those who hold large cash balances in a country with 120 percent inflation would automatically allow the government to have extra revenue. Further, street vendors pay a daily tax to the municipal police simply for being on the sidewalk. That tax, in Lima alone, is twice as high as all of the formal property taxes in Peru. In total, between 50 percent and 60 percent of

government revenue comes from the informal sector.

The next step was to explain why this was being done illegally. To do this, we used two methods. The first was to simulate the creation of a factory. We set up two sewing machines as a workshop outside of Lima and hired an administrative lawyer and four assistants who went through all of the red tape requirements to register the firm. It took them 289 days, working six hours a day, to comply with the red tape requirements. In Tampa, Florida, the same exercise took three-and-a-half hours and four hours in New York.

The second method was to study the housing situation in Peru. Most Peruvians cannot build when they come to the cities in places allotted for housing since they are poor. They usually opt for building on a sand dune. When we recorded the histories of those who had done this legally, it turned out that it took six years and eleven months, working eight hours a day, to comply with red tape requirements. It involved 207 bureaucratic steps with 51 government departments. Similarly, it took the street vendors 12 years to comply with the requirements needed to start building a market.

We found out that it wasn't only the fact that there are many obstacles to creating wealth - it was also a lack of facilitative law, the lack of some of the institutions that account for the growth of the west. For example, we found out that property rights were very important. We studied over 38 young towns and found that ten years after settlement, the value of homes that had property titles was nine times the value of homes lacking secure title.

We also found out, of course, that it was not only a question of property rights; it was also a question of contracts. To get credit, you need property rights because property rights provide the collateral that allows you to go to the bank. The reason why the poor are not getting credit is the lack of collateral — clear title to land or possessions that allows the guarantees with which banks, both official and private, can function.

Further, if you have a limited liability corporation, you can have a group of contracts to organize a business. You can agree among shareholders how profits are distributed, and you can make deals with third parties. Since it takes 289 days before access can be had to legality, most producers in Peru do not have a formal business organization. As a result, most Peruvians will have to associate with people they can trust, family or friends, because of the lack of enforceable contracts. This has been to the delight of many anthropologists who have visited my country and said, "Peruvians like to work in large families, and they like to work with people they know." But it

is not so much that Peruvians like to work with family or close relations. Good contracts, good property rights and access to the courts are missing in the informal sector.

How is it possible that all of this came about? To answer this, we began looking at the production of law or what could be called "rule-making," and we found out that one of the reasons for this situation is the way laws are made.

In Peru from 1948 to 1985, on average, the government produced 27,400 rules a year -- 111 rules each working day. Further, 99 percent of these rules were produced by the executive branch. We then compared the way law was produced in the United States and found there are three basic ways of producing law.

One way is through common law. In the United States, there are thousands of courts with independent juries, a lawyer and a prosecutor that create jurisprudence. It is very difficult in a system as transparent and decentralized as this to create a norm or custom that means adding to the 289 days of red tape, for example.

The second way of producing law in the United States is through the parliament. The people elected to Congress have to be popular in their own geographical area. Once they sit in Congress, they are continually supervised by constituents. That is why there is an enormous amount of mail between the two. In my country, we have a parliament as well, but it is not the result of popular elections in certain locations. Members are elected by a party list system, so it becomes important to be as high as possible on the list to ensure election. So in the end, the congressman or senator is interested in satisfying the executive committee of his party, not necessarily in satisfying the people who elected him.

Last but not least, we found that the United States also has executive branch law. But the regulators are themselves strictly regulated. Office of Management and Budget rules oblige people putting out regulations to do cost-benefit analyses. There are hearings where different opinions are heard, as well as comment and notice periods.

So, one of our findings is that the reason for Peru's enormous informal sector is that there are no institutions to provide democratic feedback. Our democracies are understood purely as an electoral exercise. We democratically elect a dictator to rule for the next five years. From the moment he is elected until the moment his term is finished, there is no way to control the way rules are produced.

As we continued to analyze our institutions in relation

to Western institutions, we found that another vehicle missing is a totally free press. Today, 60 percent of all advertising and 100 percent of credit is controlled by government. Therefore, the press cannot be used as a vehicle to bring information to legislators and politicians. In part, this is because Peru doesn't have systems such as the U.S. Freedom of Information Act and the oversight mechanisms that ensure that the executive branch cannot exceed its power.

Because the critical institutions are not in place, a spontaneous market economy has emerged in Peru and elsewhere in Latin America that is not reflected in the law or ruling philosophy of governments. Therefore, if we start concentrating on institutions and the adjustment of these institutions to reality, we can find peaceful roads to market economies, democracy and prosperity.

Marcos Victorica

Marcos Victorica is head of the Institute for Contemporary Studies in Argentina. He holds a master's degree in economics from the Catholic University of Argentina and is advisor to several financial institutions and a member of several corporate boards of directors. He has held public office as national director and cabinet advisor at the Ministry of Economy. He is a founding member of the Institute.

To begin, I would like to indulge in a moment of reflection. As we know, the Dow Jones index of stock prices recently fell -- some say as a result of the budget deficit. Well, imagine that the Federal Reserve Board could double the budget deficit of the United States with just a couple of resolutions and without any intervention by Congress. Think what might happen. In a few minutes we will see how this is possible, and in fact it has been done in Argentina.

First, I would like to point out that there is a difference between the way the informal economy works in Argentina or other countries in the Southern Cone of Latin America and the Peruvian or other Latin American cases. Argentina, as a country based on European immigration with no indigenous population, is different from Peru with its large indigenous population. In Argentina, there are no cultural differences or barriers that could explain the informal economy.

As a matter of fact, Hernando de Soto talked about the street vendors as a representative part of the informal sector. In Argentina, although we have some street vendors, the most important part of the informal economy are what we call the

“invisible people,” people in business suits who work informally.

In Argentina, the informal economy accounts for 60 percent of the GNP. But informality in the industrial sector is about 60 percent of the total as well. That means that informality is not simply a service sector problem but also an industrial sector problem. Today, 91 percent of the informal industrial activity takes place within small and medium industries that employ 93 percent of the industrial work force. Six out of every ten Argentines works partially or totally in the informal sector; 36 percent are self-employed.

The causes of the informal economy are inflation and privileges, public expenditure and regulation, and the cost-benefit equation of the system.

Argentina has the biggest informal economy in the world, as far as the research shows, with 60 percent of GNP in the informal sector. Argentina is also, paradoxically, one of the most inflationary countries in the world since the Second World War. Why?

Well, let me provide an example based on the proposition I made about the doubling of the United States deficit. Here in the United States, it took about a year to give a \$400 million governmental loan to Chrysler Corporation. In Argentina, in two weeks, the Central Bank distributed \$5 billion to about 150 privileged companies based on simple resolutions. Because of the relationship between our GNP and the U.S. GNP, \$5 billion in Argentina represents about \$215 billion in the U.S. economy. So that represents a doubling of the deficit in just two weeks through a few Central Bank resolutions.

This example explains how the system in a country like Argentina works and why it is difficult for the people to obtain control over the government. That's one of the major reasons why the informal economy is a way out for people who do not want to pay the bill for all of these expenditures.

There is no accountability in the Argentine case. One or two months ago, the computer system of the second largest national bank burned out. That means that there were no records about credit or loans. At the same time, if you want a telephone, you may have to wait 40 years.

What this really illustrates is that the major problem in an economy like Argentina, where, as I said, there are no cultural barriers, is the cost-benefit equation of the system which determines what you get for your money or for your effort. That problem is clearly illustrated by the fact that Argentina used to be a country with a large immigration but

now has started to experience large emigration.

The basic reason why people emigrate is that they ask, “What can I get for my effort and my knowledge in this economy?” In Argentina, they will say, “Well, if I am an engineer or an economist, I probably will have to drive a taxi as well, and with 20 percent monthly inflation, I will never be able to get a savings account, a house or a car.” And they say, “Well, with the same amount of effort and knowledge, what would I get in other economies?” Of course, they will get much more.

The same reasons explain what we call the monetary emigrants or informals. Informality is how people who don't want to leave the country emigrate. They don't emigrate physically; they just do it monetarily.

The informal economy in Argentina is absolutely sensitive to economic policy. When you have economic policies that control prices and exchange rates, increase public expenditures, and promote a lot of regulations, the informal economy increases. From the 1960s to the 1970s, the informal economy increased from about 40 percent to 60 percent of GNP. In the 1930s, when Argentina was mainly free, the informal economy was about 20 percent of GNP. That means that the informal economy responds to economic policy.

Another point I would like to stress is the relationship between international debt and the informal economy, two topics that are not usually seen as related. Let me begin with the financial market. In the 1940s, financial assets were about 40 percent of GNP. Now they are no more than 10 percent of GNP. But if the formal financial assets are combined with informal assets, the figure is 40 percent of GNP. This means that the change is not in the total amount of assets but in the portfolio. During the last 40 years, Argentines have shifted assets from the formal to the informal economy.

Argentina now owes \$50 billion in foreign debt. At the same time, Argentines have \$25 billion in foreign deposits plus \$8 billion in overseas real estate and \$5 billion in bills owed to us. That means that the average Argentine used more dollars than local currency. In the last three years, Argentina has had the lowest rate of investment in relation to GNP since 1919. Thus, capital flight is caused by the same factors as the informal economy. If the causes are the same, then the remedy is also the same. The problems of the foreign debt might be solved with the same kind of measures that would integrate the formal and informal economies.

What is the agenda for integration of the two systems? First of all, I think the most important tool is income redistribi-

bution. Income redistribution would not be allowed through the tax system but through the free enterprise system. This involves the liberation of individual creativity, competition, social mobility, property rights, the elimination of inflation as a major channel of privileges, and reorientation of public expenditures toward social aims.

The policies to achieve these objectives are to democratize access to markets, eliminate regulation without cost-benefit analysis, expose subsidies, unify effective tariff protection and reduce public expenditures. Privatization of state-owned companies is another important method. With 500 public enterprises, Argentina is in third place among non-communist countries as a socialist country. Improving standards of competition for state contractors is another important point. For example, the railroad company pays \$490 for each guard's uniform while a suit in Buenos Aires costs about \$50.

Just as costs are one of the problems, the benefit side of the equation is another problem. The reorientation of public expenditures is very important. For example, in education, public expenditures should help lower-income sectors, quality should be improved, scholarships should be awarded, and investments made in teacher preparation. At the same time, increased public expenditures should be invested in public health, safety and crime prevention.

The consequences of change will be basically two: a real democracy extending the power base in society and a mobilization of the growth forces giving individual initiative and creativity a chance as the dynamic element of the economy.

Robert Litan

Robert Litan served as discussant for the panel to comment upon the presentations by Hernando de Soto and Marcos Victorica as well as Douglass North's introductory remarks. Litan is a senior fellow in the economic studies program of the Brookings Institution, where he is also director of the Institution's new Center for Economic Progress and Employment. Litan is also counsel to the Washington law offices of Powell, Goldstein, Frazer & Murphy, an Atlanta-based firm. He received his law and Ph.D. degrees from Yale and his bachelor's from the Wharton School of the University of Pennsylvania.

I was asked in delivering these comments to expand upon the implications of the informal sector concept for economic development in general. What I would like to do first is get some terms straight.

First, it is a mistake in my view to equate the terms "underground economy" with the term "informal sector." As it is generally used in the United States, the term underground economy refers to individuals engaged in drugs and organized crime. So for example, estimates of the underground economy in the United States, between 5 percent and 15 percent of GNP, refer to criminal activities. When Hernando de Soto and Marcos Victorica talk about the informal sector, they are referring to otherwise legitimate commercial activities such as driving taxis, selling clothes on the street and so forth that are carried out without complying with all of the technical, legal requirements, such as having a license and paying taxes.

The research about "informal activity" raises fundamental questions. For starters, it suggests that for too long, most economic development theories have been far too simplistic. Take, for example, the neoclassical production function approach to economic growth. What this basically says is that you can figure a country's rate of growth somewhat like baking a cake. What you do is you add some savings, some investments, some population growth, some technological progress, and, presto, you know the growth rate of output. Now, countries that have large informal sectors have problems in attempting to make their economies grow. Their savings and investment rates will be well below the optimum level. They will have a severe problem that is entirely assumed away in the neoclassical growth model. That is, their resources will be wasted or used in a highly inefficient manner. For economists, these economies will be well inside their production possibility frontiers.

Now, as Douglass North has shown, capitalism won't work unless some basic minimal institutions are in place. People have to know that their contracts will be enforced and their property protected, either by custom or by a court; otherwise they will trust no one, and they will just engage in activity by themselves. More importantly, they won't invest because if you don't have the confidence to sell anything to anybody else, why even bother to save and invest? In short, as Adam Smith explains so well, economies in which individuals do not specialize in that which they do best will not grow very fast.

Clearly, in the face of these facts, in my view, the challenge to the economics profession and specifically to development economists in the future will be to try to bring some of these concepts into their work. For example, a couple of years ago I worked with some economists at de Soto's Institute, and we calculated that productivity or output per manhour in the informal sector was roughly one-third of that of the formal sector. We further calculated that if you were able to close half of this gap between productivity levels, you could increase Peru's GNP by 25 percent. In other words, you could increase the growth rate at roughly 2 percent a year if you

closed this gap in about ten years.

Let me conclude with just a few observations on what should be done to integrate the informal and formal sectors. First, you obviously need to do some negative things such as curtailing excessive regulation, getting rid of red tape; knock down the 289 days that Hernando talked about.

But very important in this negative "laundry list" is trying to reduce interest rate regulation. Interest rate regulation leads to massive distortion of capital. It leads to a flow of resources to large state-owned enterprises and formal firms which probably have lower marginal rates of return on capital. Interest rate deregulation can't be done all at once because of severe macroeconomic fallout, including a diminution of investment and so forth. A challenge to policy-makers is to figure out how to bring about a transition from a world of severe interest rate regulation to a world of deregulation and better allocation of resources. As an example, in the United States, we started with large depositors. We deregulated the rates on these accounts and gradually, over ten years, moved down to the middle class. That may be a model for other countries to follow.

Another thing in the capital market area is to privatize the banking system. They have done the opposite in Peru. A nationalized banking system will suck up all of the scarce capital in the economy, channel it to the state-owned enterprises, fund the federal government deficit, and generally deprive the private sector. That obviously has to change.

There are some positive things that can be done as well. What's interesting about Douglass North's and Hernando de Soto's work is the importance of what they call the facilitative aspects of law -- building positive institutions such as contract, property rights and tort law. These are things that economic development theorists don't even think about. However, these institutions have to be in place in order to have economic growth.

The final point in terms of change is a controversial one, but I'll suggest it, at least for consideration. I refer to the debt crisis, something that Marcos Victorica talked about. Most of the plans that have been offered for dealing with the debt crisis, the Baker plan and the Bradley plan, suggest that the way out is to have debtor countries commit to certain market-oriented reforms in exchange for either borrowing more money or, in the case of the Bradley plan, for debt relief.

Now, I happen to believe that this quid pro quo or conditionality framework, can be used effectively by institutions right now and specifically by the World Bank, which has a large structural adjustment lending program. It could be

made to work if the structural adjustment conditions were the quid pro quos that would bring the informal and the formal sectors together. In other words, give more money or debt relief in exchange for reducing red tape, reducing regulation, and showing meaningful progress toward meeting these objectives.

The question I leave with participants at this conference is whether such pressure would work. This is an important topic because it raises the issue of whether you can reform from the inside or from the bottom up or whether you have to have pressure from the outside. Americans tend to believe that you need that pressure from outside, but maybe it can be done within these countries as long as there are people who recognize the importance of making these kind of changes.

Discussion

The main thrust of the discussion session that followed the conclusion of the panelists' remarks was to probe into the solutions to the questions of informality and economic growth. One speaker, for example, pointed out that it was assumed that privatization will generate democratic open-market systems but asked whether it is not more realistic to think that privatization will create more privileges and monopolistic situations. Both Hernando de Soto and Marcos Victorica agreed with the point raised. Unless competition is brought into the system through deregulation, monopoly will continue to exist, and it does not matter much if it is a public or a private monopoly. The key change that needs to be made is to remove the barriers to the functioning of markets.

Another question, addressed to de Soto, was "What are the attitudes toward the informal sector?" In response, de Soto explained that the biggest success his institute had achieved was to draw the distinction between the informal and underground economies, cited by Robert Litan earlier, to show that informals are not criminals. Further, most of the populist political parties viewed the informals as unemployed proletariat, not as entrepreneurs. That view is now changing as the left in Peru comes to realize that they are, by and large, small or micro-entrepreneurs. Now the left, including the Communist Party, has begun to support the various recommendations put forth by the Institute for Liberty and Democracy. But they tend to think of the situation as similar to that in Hungary or Yugoslavia. The right has not yet become as supportive.

Marcos Victorica was asked, "Is the primary cause of informality poor facilitative law and barriers to market entry?" Victorica explained that in Argentina informality includes 100

percent of the population but not 100 percent of its activities. Everyone seems to engage in both formal and informal activity. There are no clear barriers to get into the formal and informal sectors. It's a problem of profitability and risk.

The last question of the session provided a means for the panelists to offer some concluding remarks on the general trends regarding the informal sector in their countries. The question was "The informal sector is receiving more and more publicity. As governments become more aware of the significance of this sector, is it leading to increased efforts by the public sector to regulate these entrepreneurs, which will force even more difficulty for micro-businesses' development, or is it leading to liberalization of the institutional constraints?"

De Soto responded by noting that both trends are evident. President Garcia recently nationalized the 20 percent of the banks that had been privately held, but he did this in the name of the informals. Although this is obnoxious because the institute does not agree with nationalization, it was an interesting victory because it was the first time that a political party had accepted that the informals were entrepreneurs, not simply unemployed proletariat. Further, the formal private sector just issued a declaration saying that they would join forces with the informals to try to improve legislation that affected the economy as a whole.

Victorica pointed out that in Argentina the informal economy demonstrates that the system isn't working anymore. It is showing that people are voting with their feet against the regulations that created the problem. The informal sector also demonstrates that people have the initiative and creativity to overcome the regulations and restrictions of the system.

Robert Litan sounded a note of pessimism because, in his view, the instinct of government is to clamp down and regulate the informals. Further, the situation arose from rent-seeking behavior, from the iron relationship between government and the wealthy private sector. As Mancur Olson notes in his book, *The Rise And Fall Of Nations*, the fall of nations is due to exactly this relationship between special interests and government that blocks change. It may take a massive revolution to break this relationship and create change. As asked earlier, will change be possible from within, or will it take some external force, like the World Bank, to create change?

De Soto concluded the panel discussion by offering a rejoinder to Litan's note of pessimism. "I believe that if what we are seeing throughout Latin America is true — that 50 percent or more of the population of our countries have already revolted against the monopoly legislation of the state -- the peaceful revolution that is necessary for change is, as a matter of fact, taking place. All we are doing is documenting it. It has already started."

PART III

**GENERATING ECONOMIC GROWTH THROUGH MICROENTERPRISE
AND INFORMAL SECTOR ASSISTANCE PROGRAMS**

- Moderator:*** George M. Ferris, Jr., *Ferris and Company*
Arthur Levi, *International Finance Corporation*
Nancy Berry, *World Bank*
Kenneth Cole, *Inter-American Development Bank*
Edward Marasciulo, *Pan American Development
Foundation*
- Discussant:*** William Baez-Sacasa, *formerly of the
Nicaraguan Development Foundation*

The second panel examined the role of international institutions in addressing the needs of the informal sector. The panel was moderated by George M. Ferris, Jr., a member of the CIPE Board of Directors. George Ferris is the chief executive officer of Ferris and Company and a former governor of the New York Stock Exchange. He is chairman of the Agency for International Development's Loan Review Board and served as a member of the President's Task Force on International Private Enterprise.

George M. Ferris, Jr.

Having explored the causes and dimensions of the informal sector in two key countries, Peru and Argentina, during the first session, the second panel will examine the attitudes and programs of several international financial organizations toward the informal sector and market economies, in general. Represented here today are the International Finance Corporation, the World Bank, the Inter-American Development Bank and the Pan American Development Foundation. The first three organizations are inter-governmental organizations while the last, the Pan American Development Foundation, is sponsored by the Organization of American States but is a private organization.

The aim of this conference is to demonstrate the potential economic and political influence of the informal sector. However, the long-term goal of all our efforts should be to liberalize political and economic institutions, thus tapping the informals' entrepreneurial energy to promote economic growth in the developing world. I have asked each of our panelists from these international development organizations to address the ways in which their organizations and their programs can help to accomplish these goals.

Arthur Levi

Arthur Levi joined the World Bank in 1973 as a senior agricultural projects officer. In 1983, he moved to the International Finance Corporation where he serves as senior investment officer. Arthur Levi served as a volunteer with the Peace Corps in Kenya from 1964 to 1966. He has a master's in business administration from Columbia University.

When first asked to speak today, I thought that the International Finance Corporation (IFC) didn't have much to contribute to the theme of this conference, which is microenterprises in the informal sector. The IFC doesn't directly support or encourage the informal sector although their activities certainly grow out of some of our investments. The minimum size of an investment in which we can participate is \$3 million. Nevertheless, after reading the background information and attending the first session, I have come away with the thought that we really do have quite a lot to contribute to this kind of activity. We are part of the solution.

The IFC was established in 1956 to supplement and work alongside the World Bank in its efforts to stimulate growth for the private sector in developing countries. The

corporation's distinctive role and comparative advantage is made possible by two powers given to it, which are not accorded to the World Bank. One is the authority to engage in equity financing, and the second is that we do not accept government guarantees in any of our lending.

The IFC generally invests in projects with a minimum size of \$3 million. We can rarely finance more than 25 percent of any deal. Our equity participation is seen as a catalyst. We don't care to have a majority and often don't participate on the boards of the companies in which we have equity. Our equity participation is usually limited to 10 percent. We refrain from supporting activities that are not economically viable, that is to say, those activities that depend for their success on high tariffs or artificially supported prices. Over this past year, we approved 92 operations of loans and equity in 41 countries. We lent \$800 million for projects whose total investment cost was \$4.3 billion.

The IFC's traditional role in project financing is only part of a much wider role we are beginning to play in the world of private enterprise. In the past several years, our activities have included financing smaller companies through equity lines of credit to development banks, although I must tell you that this has generally not been too satisfactory — there are exceptions — because of how very politicized these development banks are in many countries. Also, we are offering more and more advisory services on a host of different issues. We are presently helping corporations, both on technical and financial grounds, in eight African and eight Asian countries. We also have a government advisory service, which is helping governments increase the efficiency of bureaucracy; decide which kinds of taxes are worth keeping and which aren't; increase the rate at which corporations can register; and handle other issues of this sort.

The needs of IFC countries and clients vary. In sub-Saharan Africa, where private sector development and large investments are limited, we have established two institutions aimed at further promoting private sector development. One is the African Project Development Facility cosponsored by the United Nations Development Program and the African Development Bank. The project has offices in Abidjan (Ivory Coast) and Nairobi (Kenya) to serve small enterprises, those whose investments are generally no greater than \$500,000. These offices give technical assistance to make these enterprises more bankable. We have also helped create an African Management Company to provide management support. This is supported, in part, by the Industrial Council for Development based in New York.

What could an institution like the IFC, which frankly is in the mainstream helping large scale enterprises, do? Well,

one thing we can do is to help any of you who are interested in our experience. We have innumerable experiences in every country. I would urge you to use them as a resource to help document your cases. We also offer a very solid engineering department. Therefore, should any of you be involved in promoting or stimulating various sectors, I would urge you to contact the IFC.

Nancy Berry

Nancy Berry is chief of the Industry Development Division of the Policy Planning and Research Complex of the World Bank. From 1976 to 1982, she was one of the pioneers in expanding World Bank lending to small -scale enterprises and industries. In this capacity, she was responsible for developing small -industry projects and components in several countries in Latin America, Asia and Africa. She co-authored the World Bank policy paper on "Small Scale Enterprise and Employment Generation."

First, I'd like say that I am very impressed with the interest in the informal and microenterprise sector that is manifested by the turnout at this meeting. Unfortunately, since I have some controversial things to say, this just may mean that I offend more people than I anticipated.

I'd like to talk about two areas in which I think the World Bank does reasonably well and then about an area which, I would argue, we do not do well and maybe should not do well. The first is small and medium industry lending and assistance. The second is policy change, which I think links to some of the discussion in the first panel on the role of the World Bank and similar institutions in inducing policy change in the regulatory environment. These are two areas that I think we are coming to do reasonably well.

The area which is a weak point for the World Bank is microenterprise and direct links with the informal sector. I will argue a bit later that, by virtue of the nature of large international institutions, it must remain a weakness.

In small and medium industry lending and assistance, the pattern has been quite dramatic. Ten years ago, the World Bank lent nothing to small industry; today, it represents one-third of our industrial lending portfolio. Small-industry programs are active, and we're now on the second, third and fourth series in several countries of Asia, Latin America and Africa. Many of these operations also involve policy reform packages.

I think the bank improved its small and medium industry lending for firms with fixed capital investment on the order

of \$5,000 to \$100,000. We involve the commercial banks, as opposed to the standard government development banks, and build institutional capabilities at the head office and in the branches. We provide attractive spreads to account for higher administrative costs as a percentage of the loan size, insisting on commercial rates. It has been demonstrated that, for small and microenterprise, it really is a question of access as opposed to subsidized rates.

In addition to these credit services, we have moved away from traditional government, technical, managerial and marketing services and into some fairly innovative means to capture private sector expertise. For example, in the case of India, we have adopted a subcontracting approach to encourage the government to release controls on large industry, which had become constraints to both large and small industry, and encourage small firms to move to medium scale through credit and technical facilities.

We recognize that governments often interfere with firms' needs for technical services and a more outward-looking approach in terms of market channels for exports. We have created special funds that are administered outside of the government infrastructure. For example, in Nepal, 300,000 people are employed in the carpet sector in very small micro-enterprises. Private traders, operating as oligopolies or monopolies, had jacked up the price for wool yarn from Tibet by 200 percent to 300 percent. The World Bank played a catalytic role in forming a local trading company, consisting of the manufacturers, which brought the prices down to competitive scales. In these companies, repayments have been very good. Half of the firms financed were new; half were experiencing modernization. The employment effect has been substantial.

However, in my observation, the World Bank tends to still play too much of a passive role. The Industrial Development Division is trying to find ways to introduce dynamism into the components of bank projects.

The other area into which the bank has put its chips over the last five years is policy change within the macro-trade, industrial and financial sector environments. Comments made in the first panel demonstrate that much of the regulatory environment that governments have set up tend to bolster large-scale incumbents and make it quite easy for them to remain fat and happy, rather than adjusting and responding to changing markets and technologies.

One way the bank has played and can play an increasing role is to demonstrate to governments how the impact of intervention in the industrial sector has many unanticipated and adverse effects, even within their own set of objective

functions. This is the type of work we have undertaken in Argentina, India and Pakistan and have started in Brazil.

It is very difficult to use the leverage of even very large amounts of money to get governments to take actions that they do not believe will have a positive effect. However, it is possible to demonstrate that while governments think they are protecting the small firm, they really are hurting them, as well as consumers, industrial development and the country.

However, while recognizing that the informal sector is very large, this does not necessarily mean that it should be a major focus of attention by international development organizations. First, in major segments of the informal sector, assistance really means, in my view, robbing Peter to pay Paul without any net additional economic return. Second, there is a misfit between the systems and size of many international organizations and the needs of microenterprise.

Local organizational infrastructure is probably the key to assisting small and medium firms and, even more so, to assisting microenterprises where the credit decision really has to be based on character. It is becoming increasingly recognized that micro and small enterprise development may be more complex to manage than large-scale industry.

The World Bank is haltingly becoming involved in microenterprise. We are trying to pair our resources with competent private voluntary organizations that have both the managerial competence to act as a source of managerial and technical assistance, and to play a role in screening potential entrepreneurs. One example is Women's World Banking, a strong private voluntary organization operating in 50 countries. Complementary inputs from, for example, the Women's World Banking network can provide technical and managerial services and credit guarantees that can be coupled with the resources and policy-based components of the World Bank.

In summary, I would say that the World Bank is likely to stick -- in a sustained way, I hope -- to small and medium industry lending, including the use of subcontracting to bring these firms into the global economy. We will probably go slowly in the microenterprise area, as all international organizations should. My observation is that microenterprise initiatives can easily be drowned by too much money. When you do find the organization infrastructure at the local level, you easily find three, four or five bilateral and multilateral organizations competing to lend or grant money to these groups, which is an easy way to drown the kind of organic buildup required for the success of these programs.

Kenneth Cole

Kenneth Cole is the co-ordinator for Programs for Financing Small Projects with the Inter-American Development Bank, where he has held a variety of financial and administrative positions. He assumed his current position in 1979 and is responsible for developing credit projects for low-income populations. Prior to joining the bank, Mr. Cole served with the Peace Corps in Guayaquil, Ecuador, where he developed community credit systems. He has a bachelor of law degree from the University of California at Berkeley and is a member of the California and Washington, D.C. Bar Associations.

First, a quick word about the Inter-American Development Bank (IDB). We are a regional development bank. The African Bank, the Asian Bank and several others are patterned in the same mold. We operate something like the World Bank on a regional basis. We are owned, in our case, by about 43 countries. Most of the IDB's operations are for public works, public sector projects and public policy enhancement, all to the tune of about \$3 billion per year.

About ten years ago, the IDB created a special window for financing small projects with some unique characteristics. It has given us considerable experience relevant for understanding the makeup, the problems and the aspirations of the informal sector in Latin America. With the small projects program, we have a facility for making credits on very soft economic terms to not-for-profit private organizations in Latin America and the Caribbean or to special government agencies, which undertake activities for the informal sector.

The small-projects program works with about 160 private voluntary organizations in 22 countries. Through these organizations, we are supporting a variety of activities that enhance income generation and jobs among the low-income groups by dealing with agricultural credit for small farmers and credit for urban microenterprises, cooperatives and associations. Altogether, this makes up about a \$70 million portfolio.

Of the \$70 million in activities, about \$22 million to \$25 million have gone into 50 operations just for urban microenterprise. Microenterprises usually have fewer than five employees. Often, microenterprises are mom-and-pop, family-owned enterprises with total assets of less than \$5,000. Sales are in the area of \$3,000 to \$4,000 per month. For the most part, they produce popular goods services for the popular part of the economy. In some instances, there is some vertical integration with the formal sector. One that comes to mind is the situation in Monterrey, Mexico, where microenterprises hand-make molds for the aluminum foundry industry.

Most of our microenterprise projects have some specific characteristics. Usually we look for a private voluntary organization with which to cooperate. We look for organizations that have a business mentality, understand the use of credit and the bottom-line approach to business and yet are willing to risk their time, effort and capabilities in working with very low levels of the economy. We provide credit on virtual give-away terms to the private organization. We expect that organization to deal with the carpenter or shoemaker on commercial terms with real interest rates. In fact, they are dealing with much higher-than-real interest rates and are probably paying 10 percent a day on loans from informal sources. The IDB seeks to ensure that there is some kind of training involved with the application of credit.

When I look over these projects, I am struck by the fact that about 25 percent of the borrowers are women who are managing their own enterprises in the slums of the big cities in Latin America and the Caribbean. I note too, as Nancy Berry mentioned, the tendency for excellent repayment rates among these users of credit. Most of the programs seem to be leveling off at a rate of 85 percent to 90 percent being up-to-date on repayments. Generally, this is far superior to the records of development finance organizations and commercial banks.

I need to add a word about our experience in Colombia because it dovetails with the cautions expressed by the World Bank. In Colombia, we grew from one small project to about 15 with different private foundations in different cities. This multitude of projects became a consulting council that coordinated programs, and developed a uniform computerized data system, and uniform credit regulations and processes. They began a series of friendly consultations with the National Planning Ministry that has now become a national program in Colombia sponsored by the government. It has received a \$7 million credit from us which goes through the Central Bank, into the national financial systems, and to the microenterprises with the monitoring and collaboration of the private foundation system that initiated the program. Colombia is a complex model, but we have high hopes that this will work.

To date, in general terms, we have data that tell us that for every \$1,000 to \$1,200 that goes through these credit systems, we're creating or substantiating a job in the informal sector. Compare that to the \$12,000 or \$15,000 per job in the formal sector. Considering the funds that we have delivered, we have probably helped create about 15,000 jobs. We've probably trained 20,000 people. More importantly, we have helped strengthen local private institutions in 20 countries. These in turn have helped to educate the public policy-makers in creating the linkages that appear to us to be very important.

Obviously there are major challenges ahead in terms of a need to expand and enhance the delivery system so that the resources that are available can reach the microenterprise level of local economies. That means institution building, linkages with the formal sector and policy dialogue.

Edward Marasciulo

Edward Marasciulo is executive vice president of the Pan American Development Foundation. Prior to joining the foundation, he was executive officer, Office of the Assistant Secretary for Management, Organization of American States. He also held several positions with the U.S. Agency for International Development in Latin America. Mr. Marasciulo has been a visiting professor at George Washington, Georgetown and American Universities since 1977. Most recently he served as lead consultant on social and humanitarian concerns for the Bipartisan Commission on Central America (Kissinger Commission).

I think that it's important to explain what motivated the creation of a private voluntary organization like the Pan American Development Foundation (PADF). Twenty-five years ago, during the era of the Alliance for Progress, Sam Green, a businessman from the U.S. living in Guatemala, along with a number of his colleagues, became aware that the Alliance was only reaching 10 percent to 20 percent of the people of Guatemala. His assumption was that this problem was widespread throughout the hemisphere. He was very much concerned about the disenfranchised, the 80 percent of the population with no access to credit who are, generally, spectators of the process of development and, in his view, the motivators of the guerrilla movements that have since developed.

For those of you who remember this era, you also remember that it was a period of time when the development economists were pushing the ideas of the Harrod-Domar model and the Rostowian theory. It was also an era when the development economists began talking about structural change, when the economists were not yet talking to the anthropologists or to the political scientists. What the PADF created was an anathema to the concept of planned development.

Today the Pan American Development Foundation is not the only player in the activities that I am going to describe. There are many other organizations like ours. I mention specifically Accion International in Cambridge, Massachusetts. They're a rather outstanding group, and they have done some rather significant things throughout the hemisphere jointly with us. So, the not-for-profit community is rather sizable

these days. It wasn't 25 years ago. What is lacking these days is an inventory of all of the players in the development business in microenterprise activity.

What did we find during our experience? We found that these men and women who previously had no access to the banking system because they had no collateral were exceedingly good credit risks. We found the need in many cases to take people by the hand into the bank because they had no ability to deal with the structure of the bank or to even open a bank account. Therefore, we found that it was not only credit that had to be injected into the system. And we found that the trainer had to be, in most cases, the local formal sector. So we found the need to link what we now know as the informal sector and the formal sector.

PADF had no model; indeed, we still have no model. We all learned together, and we have found that every one of the foundations that we have helped to create, 31 over the last 25 years, is different. Each one has its own idiosyncrasy.

What have we learned? We've learned that the informal sector must be used as the link, and the source of credit must be within the formal sector itself. We have found that the formal sector has a process to learn about within its own society.

I have often used the example of San Pedro Sula in Honduras. In the north coast of Honduras in the early 1980s, guerrillas came into a meeting of the chamber of commerce and held 100 of the members hostage. They spent three days with these guerrillas and went through the process of the Stockholm syndrome. They found that, indeed, the guerrillas had a philosophy and a concern. Outside the chamber were members of the very strong labor unions on the north coast of Honduras who had demonstrated against the guerrillas and in favor of those who were being held hostage inside. It was through the demonstrations of those labor unions that the hostages eventually left the country. From that experience, the formal sector of San Pedro Sula, which is well-known for its progressive activities, created a foundation with a portfolio of roughly \$5 million. They now have their own formal sector very much involved in the concern of what we might want to call the enterprising poor. They see it as being for their own security and for their own future.

This is not a unique experience. The same thing happened in Jamaica when Seaga came in as Prime Minister and recognized the quick political change in that environment. One of the first things the government did was create a national development foundation as a means to provide credit to the informal sector through the management operation of the

formal sector itself. It now has five branch offices throughout the island.

So our concern is not just a matter of economics, nor is it solely a concern for job creation. In many ways it's a concern for survival, and I think the survival mechanism is just beginning to explode throughout the hemisphere.

There is a growing need and desire for the creation of private organizations in the hemisphere well beyond what we had expected 25 years ago. There are many links with private organizations in the U.S., but our goal is to build a local foundation run by the local private sector. I daresay it will be happening more and more over the next 25 years.

William Baez Sacasa

The discussant for the program was William Baez Sacasa, a consultant to the Pan American Development Foundation and the Cooperative Housing Foundation of Washington, D.C. From 1970 to 1985, he was the chief executive officer of the Nicaraguan Development Foundation and the Nicaraguan Development Institute. He is author of the Informal Sector in Latin America: A Preliminary Overview and Nicaragua: The Informal Sector in Transition. Mr. Baez has served on the board of the Superior Council of the Private Sector (COSEP) in Nicaragua and the Pan American Development Foundation. He graduated cum laude from Holy Cross College, Worcester, Massachusetts.

I would like to take issue with what was said this morning and what is being expressed by our panelists this afternoon. For the last five years, as a member of the private sector and as a development agent, I have felt that there are two types of models that have been developed to assist the micro-entrepreneur or the informal sector.

One model is expressed very clearly in Hernando de Soto's book, El otro sendero. It characterizes the informal sector as a group of individuals who are at the margin of the law. The way to approach the problems of informality is to help these individuals overcome the regulatory barriers to make the informal sector more formal or the formal sector more informal. The stress is on the need to change the law and politics of the country, which is very important.

This afternoon we have seen what I consider to be another model, which has stressed the importance of the microentrepreneur, or what Ken Cole has called micro-business. This model, which has been developed over the last 25 years by the Pan American Development Foundation, has been

adopted by many different organizations. It has stressed the credit, training and technical assistance aspects of development. To foster this type of model, significant funds have been given, over the last 25 years, through the World Bank, the Inter-American Development Bank, the Pan American Development Foundation, ACCION International and the Inter-American Foundation. The emphasis has been on the importance of the individual as a businessman; to try to move him from a small to a larger businessman.

What is very important is to complement both models: to put them together and create a single model that will address the problem of informality from the legal aspect and the micro-business or credit aspect.

In Nicaragua, we conducted a study with the help of CIPE about two years ago called "The Informal Sector in Nicaragua: An Alternative Solution". We tried to pull the two models together and find out how the informal sector behaved in a very special situation like the case of Nicaragua. Under very extreme situations, like Nicaragua, the informal sector shows its true colors or characteristics. We found that it doesn't matter that the informals live in a culture of collectivization; in the final analysis, they are entrepreneurs. They are highly motivated; they want to make profits.

If we want to stress democracy and pursue the happiness of our people, especially in Latin America, we have to cope with the problem of giving people an opportunity via the legal system, as Hernando de Soto has said, and via the credit aspect as discussed previously. A true democracy is not only voting but is a day-to-day process.

How can we strengthen and promote the informal sector? First, it's important to identify the informal sector — who they are, where they are, what type of things they do. Identification is one element.

The second element is valorization. Small entrepreneurs are important. It's important that we believe that they are people who have the willingness and the courage to fulfill their own lives.

Third, we have to stress the importance of organization. It's very important to go into the legal aspect, but it's more important to organize the informal sector for political, economic or sociological ends.

Fourth, we have to understand that there has to be a linkage between the informal sector and the private sector or between the microentrepreneur and the entrepreneur. They have to believe and understand that they belong to one private

sector in order to sustain democracy in the countries where there is still democracy. In order to fulfill the dream of democracy, you have to strengthen not only your companies but you have to provide for the strength of the informal sector.

Another important element is understanding. They need training; they need credit. They don't need it the way we traditionally do it: coming from upstairs to downstairs. In the Nicaraguan Development Foundation, we hired a loan shark to tell us how to provide credit to these people. We have to work with the idiosyncracies of the people.

The most important part, as mentioned before, is the legal support that we have to provide through regulatory reform to make the formal sector more informal and the informal sector more formal.

I have addressed the two schools and how they can be joined. In Nicaragua, the situation has changed; it is now more difficult. But I want to express this view because I know that many of you come from democratic countries. I want to leave you with the message that the informal sector is a very important element in the democratization of your countries and in sustaining the lifeblood of the private sector.

Discussion

Questions to the panel tended to focus on the issues of regulatory reform and the manner in which these multilateral development organizations carry out their lending programs. Given the constraints of time, the moderator grouped several questions together and asked the panel to respond.

The first group of questions focused on the theme of regulation as stated in the following: "If over-regulated economies in states controlled by special interest groups are causes of informality, then how do microenterprise programs help address the causes of the problems?"

Nancy Berry responded by indicating that she shared the view that it is much more important for international organizations to try to influence the overall legal and policy system. She also felt that the policies had to go beyond getting the exchange rate right by getting into the policies, particularly in the industrial regulatory area, that are restricting internal competition.

Ken Cole agreed and indicated that he hoped that as the World Bank and the IADB approach structural adjustment, they will take into account not just needs for housing, roads and services but also look at what is needed to provide market

conditions for informal jobs and products. Cole also noted that the banks should be looking at the potential to mobilize savings in the urban sector as it relates to the informal sector activities which, as noted, are between 40 percent and 60 percent of GNP. This would also require looking at the regulatory environment in the banking sector that impedes their ability to lend to microentrepreneurs.

The second group of questions focused on the manner in which multilateral organizations carry out their lending. One question was about the need for subsidized lending and a second about the possibility of bypassing government-to-government lending programs. Conversely, the third questioned the usefulness of lending through private voluntary organizations.

Edward Marasciulo responded by noting that those in the development community tend to look at development in terms of government-to-government programs but that what is

really needed is to find ways of using the private sector as an agent of change. The governments control these lending institutions, and unless you can break the government-to-government relationship, the activities dealing with the private sector won't function.

Nancy Berry added that the panel was agreed that lending to microenterprises should be at commercial rates since they can pay commercial rates and that they normally, without some type of program, pay more than commercial rates. She also argued that governments cannot be bypassed since they tend to be a major part of the problem in terms of industrial and financial regulations. The challenge is to structure lending operations in such a way that you deal with the overall policy environment. With respect to private voluntary organizations, Ms. Berry cautioned that it's important to find groups that operate with business objectives and have the appropriate managerial and organizational apparatus to be an appropriate grass root creditor/technical service intermediary.

PART IV

BUILDING GRASSROOTS CONSTITUENCIES FOR ECONOMIC CHANGE: APPROACHES

- Moderator:** Jose Luis Yulo, Jr., Philippine Chamber of Commerce and Industry
- Peru Hernando de Soto, Institute for Liberty and Democracy
- Paraguay Martin Burt, Paraguayan Foundation for Cooperation and Development
- Argentina Adolfo Ruiz, Institute for Contemporary Studies
- Brazil Dr. Joao Geraldo Piquet Carneiro, formerly of the Ministry of Debureaucratization
- Luis Eduardo Magalhaes, Chambers of Commerce of Sao Paulo
- Discussant:** Edward Hudgins, Heritage Foundation

The topic of building grassroots constituencies for economic change was split into two parts for convenience of presentation. The first part focused on various private and public sector programs designed to remove the causes of informality. The second part of the panel, reported in the next section of this booklet, sought to determine if these experiences can be replicated in other countries, particularly outside of Latin America.

The moderator of the panel was Jose Luis Yulo. Mr. Yulo is vice president and founding charter member of the Philippine Chamber of Commerce and Industry and is the managing director of the Philippines Center for International Trade and Exhibitions. He is also a board member of the Lokalota Sugar Central, the Rural Bank of Mactan and Unitrust Bank. Mr. Yulo received his master's in business administration from the Asian Institute of Management, has taught at the de la Salle Graduate School of Business, has written several books, and is a regular columnist in various Philippine newspapers.

Jose Luis Yulo

As I listened this morning to Hernando de Soto's description of the informal sector of Peru, I thought for a moment that he was a Filipino, for he struck many a nerve in my system. I am sure that each of you here today identifies with him not only because he has given impetus to a new, conscious effort to study the informal sector which exists in all of our countries but also because of the intriguing potential and power that the informal sector can unleash.

In the first session this morning we tried to get a better understanding of the concept of the informal sector, or, shall we say, the "black market," the "black economy," the "underground economy," the "parallel market." I think the name we call it depends on how diplomatic we want to be and the personal, cultural preferences of each country. In the second session, we examined some assistance programs that are now available to the informal sector and microenterprises. It appears that some of these assistance programs need adjustments, if not outright changes, to better interlock with the informal sector.

Now in this session, we shall discuss ways and means to change institutional structures, policies, laws and regulations, if need be, in order to harvest the full potential of the informal sector. As an example, during the 1960s, the Philippines was second only to Japan in economic advancement in our part of the world. After going through a strong statist government, we ended up somewhere near the bottom. Current estimates by our National Tax Research Center have shown that about 44 percent to 47 percent of our economy is underground. The Bureau of Internal Revenue, when it tried to flush out the underground economy in one district of Manila, raised its revenue collections by 293 percent from the previous year.

With the new era and a new democratic government, we have come up with new directions such as dismantling monopolies in sugar, coconut and cement, to mention a few; the dismantling of crony capitalism; and the ushering in of privatization coupled with government deregulation. This has resulted in lower interest rates, lower inflation and the reversal of economic decline. This economic growth has occurred in spite of negative press releases and in spite of the persistence of some political pretenders to President Cory Aquino's position.

Worth mentioning as a program to try to build grassroots constituencies is a project that the Philippine Chamber and CIPE have worked on together. It is a project aimed at the promotion of business advocacy in the outlying provinces of the Philippines. The intention is to strengthen local chambers

of commerce and industry in the different provinces, and by so doing, use these chamber organizations to service not only microenterprises but also the informal sector.

The project is composed of four important components. The first is to identify about 20 potential speakers in a local community and put them through a spokesmen's training session so that they can relate to government, to the military, to religious groups or others.

Second, we have instituted a regular radio business program because radio is the more important medium of communication in the outlying provinces. Third, we have also instituted a mass publications campaign to inform the private sector and the informal sector in the provinces. The fourth element was to build membership in the chambers, which has increased tremendously, drawing some informal sector business groups into membership in the chamber of commerce. Because of these endeavors, we were able to establish about 50 local chambers of commerce all over the Philippines.

We have worked out a corollary project with the International Labor Organization called the IYB, for "Improve Your Business." In this project, we again identify about 20 small businessmen and help them improve their business to ensure their profitability and existence. Now, if the IYB program is simplified, it can be brought down to the level of the informal sector.

Hernando de Soto

*Hernando de Soto is president of the Institute for Liberty and Democracy in Lima, Peru. His major work, *El otro sendero: la revolucion informal (The Other Path: The Informal Revolution)* has become a bestseller in countries throughout Latin America, with over 100,000 copies sold. De Soto has a master's degree from the Institute for Advanced Studies in Geneva. He has been an economist with the GATT, managing director of an engineering firm in Switzerland, owner of several firms in Peru and a director of the Peruvian Central Reserve Bank.*

The objective for this session is to discuss building grassroots constituencies for economic change. I think this is a very appropriate title, at least for what we're trying to do in Peru. Our objectives, as you know, are to achieve development through a democratic system and a pluralistic or open market. These were the formulas that the Western democracies used to achieve the highest state of prosperity known to mankind.

Now, what we're seeing, at least in Peru, is similar to what we saw some 200 years ago in Western Europe. Capitalism is a very old thing. It existed even in the times of the Borgias in the north Italian states. But at that time it was called mercantilism and was reserved to a very few people who had the privilege of associating with a state, generally run by princes or royalty, which gave them the right to practice entrepreneurship. This system of mercantilism started falling apart when large migrations took place in Europe from the countryside into the cities. The people who arrived in the city were not pleased with the lack of opportunities. Due to both their frustrations and rising expectations, the law lacked legitimacy.

In those days, to form an enterprise, you needed a special charter from the king. Until the middle of the 19th century, only about one-sixth of all British people could actually form enterprises. However, during the 19th century in Europe, mercantilism was transformed into what are today the Western European democracies. These are the countries which managed to solve the contradictions of capitalism by making sure that entrepreneurship was open to all so that all could identify with a system of free trade, democracy and open markets.

We feel that this is now occurring in Peru. In effect, as a result of the mass migrations from the countryside into the city, large segments of the population have been impoverished over the last years; people have not seen the economic growth that some Asian countries have witnessed, and they are frustrated and need an explanation of why things are wrong.

We have been very successful in showing the informals that they are entrepreneurs but have not been successful so far in convincing them to identify with the private formal sector. As a matter of fact, to write the book *El otro sendero*, we conducted interviews with over 80 informal sector entrepreneurial chiefs. We asked them three basic questions. First, we asked, "Are you the private sector?" And 79 out of 80 responded, "no." When we then asked, "Are you the public sector?", they said, "Of course not, the public sector is government." So we asked, "Then who is the private sector?" The reply was "Those up there: the oligarchy." So we have a large private sector - an informal one - that does not identify with the private formal sector.

To try to build grassroots constituencies, the ILD in Peru has organized a system which we call "everyone's balcony."² It's a private ombudsman system whereby we raise public issues on behalf of the informal sector. One example that I mentioned in the first panel is titling. The government has only managed to build one out of every fifty homes that have been built by the informal sector, and these government-

built homes are costlier and smaller than those built by the informal sector. Since most people don't have clear title to their privately-built houses, we need to affirm the informal sector's rights as property bearers to have title to their homes and land, rather than to build more government housing.

We drew up a piece of draft legislation to improve the process of providing the informal sector with titles to land. When we presented this draft law to the public during one of our public sessions, we managed to get 300,000 signatures in less than one month in support of our draft law. We then published this draft law in the official gazette of Peru called *El Peruano*. With 300,000 signatures backing it up, President Garcia had no choice but to support the law, which he did pass — though in a rather modified and inefficient form.

We have had similar successes since then. When we have talked about removing rent controls from the informal sector in the country, we managed, in one day alone, to get 176,000 signatures. In the case of bus and truck drivers, we managed to get 310,000 signatures in support of proposals to simplify regulations.

We had an extensive debate with the communist municipal government of Lima when they brought out an ordinance which tried to organize the street vendors. When we pointed out that the law was not very modern - five out of every six articles in that law were contained in ordinances of the viceroys over 150 years before - we managed to actually defeat that ordinance. In a communique, the street vendors came out in defense of the institute's position. Actually, 111 out of a total of 120 street vendor organizations in Lima supported us.

Every time a point of conflict arises which interests the informals, we communicate with them through a system of pamphlets, radio advertisements, television, debates and hearings. We interpret their positions the same way the Marxists would but in terms of producers versus the state, not of rich versus poor. The result, of course, is that we are using Marxist systems to communicate ideals that they do recognize and with which they identify.

We had our most glorious proof of success in connection with a project in San Martin de Porres. San Martin de Porres is an area in Lima of 500,000 inhabitants that is run by one of Peru's most radical, extreme-left parties called the PUM. The town council, including the mayor, came to visit us. They asked us to set up a mechanism of governing which would allow the introduction of a market economy and democracy the way we had outlined for the national economy and the national government. Of course we used a very different name for a market economy. I think we called it government action for a popular economy. Instead of talking about entrepreneurs,

we talked about free workers. We used all of their language to establish the internal legislation necessary for a private economy and an open, democratic system.

Once this system was publicized the executive committee of the Communist Party got hold of it and the mayor was forced to make a public autocriticism. All of the PUM council members in the municipality then resigned in disgust because of the pressure from the Central Executive Committee of the Communist Party. They are now actually working in the Institute for Liberty and Democracy.

This indicates that communists, at least in Peru, are ideologically soft. What they want is change. What they know is that they are basking in poverty. They are frustrated and want an explanation and a formula on how to end their frustration. The common denominator is change. Whoever can provide change can win their votes and their support. The important thing for them is not statements; it is action. That is why we continually try to come out not in defense but as enemies of the status quo.

Poor people are not satisfied with things as they are. If you identify, at least in the case of Peru, with things the way they are, you will have the informals against you, even if they are entrepreneurs. But if you support change, there is absolutely no reason why they will not fully identify with their status as progressive entrepreneurs. It is extremely important for those organizations that represent business to come out in defense of the informals. The formal private sector must fight against the obstacles which informals face, not only against the obstacles which they themselves face. When that happens, informal entrepreneurs will identify with formal entrepreneurs. We will then have reversed the revolution that the communists want to make.

We will only have a successful entrepreneurial revolution when we all clearly come out in defense of the poor entrepreneurs, who have no opportunities, and against a status quo which is not yet a market economy and a full democracy.

Martin Burt

Martin Burt is executive director of the Paraguayan Foundation for Cooperation and Development. A native of Asuncion, Mr. Burt graduated from the University of the Pacific in Stockton, California, with a degree in public administration and inter-American studies. Mr. Burt also has degrees from the Instituto Nacional de Administracion Publica in Spain and from George Washington University in Washington, D.C. He is co-author with Guillermo Peroni of Paraguay: Laws and Economy and has served in the Ministry of Commerce and Industry.

The Paraguayan Foundation for Cooperation and Development is a new organization, two-and-a-half years old, whose main objective is to increase family income, strengthen precarious jobs, and create new job opportunities by organizing microenterprises into solidarity groups. These solidarity groups eliminate the problems that banks have in lending to the very poor people by analyzing the microenterprises' capacity to pay. The solidarity groups guarantee the loan so that if one member fails to pay, the group pays the loan. In two-and-a-half years, we have given out loans to more than 2,000 small businesses, and we provide technical training as well.

As you may know, Paraguay has been ruled by one government for the past 33 years. The difficulties in working under that system are very significant. When we tried to organize a program to give credit to very poor people, we were told that it couldn't be done. We were told that you could not organize solidarity groups because Paraguayans were all individualistic people who would never organize into groups. We were told that the government would never allow us to operate, that we could never get funds to do it, that we would end up in jail for trying to organize these people, and that a foundation could never work in Paraguay.

A quick analysis of the external environment when we started this program told us that we faced four very serious threats: political, governmental, business opposition and a very weak financial base.

First, politically, in Paraguay it is illegitimate to organize the poor. It is a highly politicized environment. Any attempt to organize the poor or to work with the informal sector is seen as either a communist or opposition plot against the government. We have seen severe police repression in reaction to efforts to work with the informal sector.

On the government side, we needed President Stroessner's signature to allow us to open the foundation. We had to go through a series of security checks to get the bureaucracy to accept our bylaws, so we had to word our intentions in a very specific way. We had to create a board of directors of key people in the community because, in Paraguay, who is involved is more important than the objective or motive.

With respect to the business community, in Paraguay, as in many other Latin American countries, we have a very conservative business sector. They are reluctant to join the board of directors of a project that they may see as having political intentions. If they are going to support a social responsibility program, they would rather join a charity than work with a modern development organization.

The fourth threat that we faced was a very weak

funding base. In contrast to what the World Bank representative said, there are very few international donors working in Paraguay.

If you are going to build grassroots constituencies for a particular cause, you have to concentrate on building internal strengths. You have to start with a very solid feasibility study and recognize the strengths and weaknesses of your organization. You have to obtain solid legal advice, and you also have to surround yourself with prominent international auditors to show that you have transparent finances. You have to be able to develop, at least in our case, a very large loan and training scheme because the big question for a microenterprise project like ours is whether you can give out the money and get it back.

Once we had developed a program to reach thousands of microenterprises with loans and managerial training, we developed, with CIPE funding, a twin strategy. One was to educate the people on the importance of the informal sector, and the other was to strengthen and build linkages between the formal and the informal sector. I will explain briefly what our message was, the specific strategies that we used, and the tactics and the methodology.

The message that we used was very carefully worded. First, we indicated that it was valid for the private sector to pursue development objectives that were previously only in the public sector. We wanted to convince people that we were going to pursue these objectives by freeing the forces of small business and not by public enterprise. The second point was that it was valid for a private development foundation to do this. In Paraguay, there are very few foundations.

For the government, we produced a message that we were not communists or in the opposition. In exchange for us not politicizing our project, we insisted that they not politicize our project either. Basically, we communicated this point to ministries and members of the police by telling them, "If you politicize the project, the project will fail, and you will not have a system to create jobs. So it is up to you to let us proceed."

We told the local community that we were not married to the government, even though we dealt and worked with the government all the time; that we were not crony capitalists; that we were not trying to promote individualism and selfishness, but we were trying to create solidarity groups and associations of microenterprises to organize the poor; and that we were not just a loan company, but we were creating new skills. We relayed that message on a daily basis. We created a media office in the foundation whose objective was to have the foundation message in one of the 22 radio stations, one of the four newspapers or one of the two television channels every day.

We made extensive presentations to the public sector, including the various ministries and offices and to the private sector business organizations. We then went to talk to the bishops; of course, we were not talking about capitalism but about programs for the poor. All of this involved specific planning. We had to identify each group very carefully and define why that group was important. We held preliminary meetings with contacts that we had in each organization, and we prepared each presentation in the group's language. We tried to show that each group's interests would improve by promoting small enterprise and the informal sector.

The methodology included round-table discussions. Dialogue was important because every person in Paraguay has had at least one experience with small business. We took business leaders to these presentations, not young social activists. We have used advertising companies to help make the presentations and a formal evaluation company to conduct before-and-after interviews to measure the impact with the target groups.

Another strategy was to strengthen linkages between the informal and formal sectors. We had prominent business people, such as Amaury Temporal, head of the Brazilian Chambers of Commerce, speak to our business groups about the informal sector. We also created new microenterprises organizations such as the Hairdressers' Cooperative and the Forum of Microenterprises.

I would like to finish by saying that it is possible to educate the public on the importance of the informal sector and it is also possible to create linkages between the formal and the informal. We have helped revolutionize the financial and development circles. We have been able to reach thousands of poor people with massive amounts of credit and training by incorporating the concepts of informal economy and microenterprise, even in a country like Paraguay. We're doing this because we think that by democratizing private property, we may achieve liberty.

Adolfo Ruiz

Adolfo Ruiz is communications advisor to the Institute for Contemporary Studies of Buenos Aires, Argentina. He received his degree in marketing from the Foundation for Advanced Studies of Commercial Sciences. Mr. Ruiz is a vice president of Manpower Temporary Services, Argentine Branch Office.

In describing the Institute for Contemporary Studies' approach to grassroots action, I will concentrate on communications. Marcos Victorica has already described the research

findings of the Institute's studies on the informal sector in Argentina in the first panel.

In the communication area, we considered four aspects: first, communication objectives; second, the strategy of communications; third, tactics; and fourth, refining the strategy.

When the research was completed, our first step was to identify three marketing objectives in reference to the informal economy. Above all, we wanted the main decision-making segments of the population to associate our institute with the informal phenomenon.

Our marketing objectives were as follows: first, to explain that economic informality in Argentina is distinguished as much on a vertical as a horizontal dimension; that is, informals are not simply small firms. Our second objective is to halt the decline in prestige of legislative processes and the consequent weakness of participatory democracy. Third, we sought to communicate the diagnosis and treatment of the phenomenon to the diverse social groups that are affected, often without their knowledge, and which would support demands for elimination of the causes of informality.

Over the last year and a half, our strategy of communication has been oriented toward two ends. First, to unify the terminology. As happens in numerous countries, the informal economy in Argentina is subject to various terms: "black economy," "parallel," "underground," "subterranean," "submerged," "invisible," etc. Thus the task was to apply a universal term and, at the same time, extricate the phenomenon from the aura of illegitimacy that surrounds it. We believe that we have achieved this objective since the term "informal economy" has entered into general usage in the majority of communications and documents from public authorities and in those from private institutions and political parties.

Second, we wanted to publicize the magnitude of the phenomenon. For the first time, there are documented reports that confirm the impression that the informal economy is widespread and has penetrated all socioeconomic strata. Again, we are persuaded that we have achieved this objective. Today we can affirm that a large number of Argentine leaders have become conscious of the issue's magnitude and consequences for societal behavior.

The tactics we used were based on selecting highlights of our research and translating them into common language. Thus, we prepared a group of basic texts, taking special care to avoid repeating messages between each newspaper and magazine. We selected mass media with readership among de-

cision-makers and groups of opinion coalition-builders. After this, we began contacting journalists, politicians, and public officials.

The fourth step was to refine the communications strategy. Having been able to surface the issue within socioeconomic debate, the strategy of communication had to accomplish another objective: to avoid a potential detour in public opinion currents toward policies which persecute informality instead of removing the causes of informality. To do so, we identified those most affected by the informal economy and who, therefore, constituted its principal detractors. When we say this, we should not forget that those in the informal economy are also suffering from the effects of the formal system. Our strategy was to capture those sectors within the official economy that can be transformed into allies in the fight against state interventionism, mainly those that are not recipients of state favors and privileges. But it happens that many of these groups either are not aware that informality is affecting them or do not clearly understand how it is happening.

Up to this point, our investigation has been based on macroeconomic criteria, and therefore we have only partial knowledge of how informality permeates specific segments of the economy. Therefore, the next step will be to develop microeconomic criteria to approach subsegments to inform them precisely about the type and character of phenomenon that is affecting them and, above all, to present them with proposals for the removal of the causes of the informality and for the integration of the economic system. The segments and sub segments that we will select are the 500 leading enterprises, multinational corporations, businesses that call out for change, export and trading companies, business-sector chambers, professional associations, trade unions and universities.

We are persuaded that, with a thorough knowledge of these sectors, we shall succeed in our task of contributing toward a more integrated and, above all, a fairer economy since the state would not then be the arbitrary distributor of exclusive privileges.

Just as when the sun becomes unbearable we seek shade, in the same manner, when the weight of the state becomes unsustainable, the only defense of the silent majority is the informal economy.

Dr. Joao Geraldo Piquet Carneiro

Dr. Piquet Carneiro is a partner in the firm of Gols, Piquet & Lobo, specializing in political risk analysis and strategic planning. As an attorney, he specializes in taxation and commercial law. Dr. Piquet Carneiro graduated in law from the Federal University of Rio de Janeiro and completed postgraduate work in comparative law at New York University. He was professor of economic law at Catholic University and in Rio de Janeiro. In 1980 he joined the National Deregulation and Administrative Reform Program and in 1982 was appointed executive secretary. In 1983 he replaced former minister Helio Beltrao as its coordinator until the end of his term.

Perhaps the most useful contribution that I can make to the objectives of this conference is to share with you my personal experience in connection with the Statute of Microenterprises enacted by the Congress in 1984. A few words about the National Debureaucratization Program are necessary for an understanding of the circumstances under which this statute was conceived. The scope of the program instituted in 1979 was to reverse the trend toward unnecessary growth of the bureaucracy of the state and widespread inefficiency in government. This trend resulted from three ingredients in Brazil: namely, excessive centralism; rigid formalism; and generalized distrust by government bureaucracy toward society. That's what we call bureaucratization.

Naturally, poor people and small companies are the first victims of excessive bureaucratization. Thus, priority was given to the Citizens Project, a complete survey of all points of contact of individuals during their lifetime with bureaucratization requirements, and the Enterprises Project, a similar survey with respect to requirements imposed on the pre-organization and organizational stages of private companies, as well as on their day-to-day existence.

An overall attack on bureaucratization in the early stages of the program would certainly be a failure in view of the magnitude of the resistance it would encounter. For that reason, we felt it absolutely essential to adopt a gradual approach to debureaucratization in order to gain public and political confidence and support.

When the program started, virtually all commercial and industrial companies, regardless of their size, had to keep and fill in at least 13 different accounting and tax books, file complex income tax returns every year, and comply with a series of government formalities. In 1980, through the program, full income tax exemption was granted to companies with annual gross income not in excess of \$3,000, thereby benefiting 230,000 companies out of a universe of 1.7 million

active companies at the time. Federal excise tax rates applicable to products typically manufactured by small companies were reduced to zero, and payment of corporate income tax based on assumed profits was extended to companies with an annual income equal to or less than \$1 million a year. In all three cases, maintenance of accounting records related to these taxes, preparation of balance sheets and filing of income tax returns were abolished. This was not at all an easy task.

In the beginning, the Federal Revenue Department strongly opposed some of these measures for fear that exemption might lead to tax evasion. Since these exemptions would amount to less than 2 percent of the estimated tax revenue in 1981, our contention was that there would be no decline in revenue. On the contrary, the government would benefit from rationalization of its collection and inspection mechanisms. Two years later, the Minister of Finance raised the level of annual gross income for income tax exemption purposes in light of the fact that there was no real decline in revenue. Thus, approximately 40 percent of registered active companies were relieved from federal taxation and related bureaucratic obligations.

In 1981, a bill was enacted to simplify drastically the act of organization of companies. Century-old formalities were abolished, the paperwork load was substantially reduced, and cumbersome controls were eliminated. Organization of an individual firm or a limited liability company, 97 percent of all registration applications, used to consume three to six months to be completed; it is now obtained in 48 hours. In Brasilia, the registration takes 45 minutes.

The cost of organizing small companies became symbolic, and the services of lawyers and expeditors were no longer necessary. Adverse reaction came not only from the bureaucracy but from professional groups as well. Lawyers, a very powerful group in Brazil, felt that they were losing a share of the market. Accountants organized lobbies against the elimination of bookkeeping procedures. Expeditors, of course, were extremely unhappy with the course of events.

At that stage, the debureaucratization program had become very popular, and we decided that the time had come for bolder action. We had attacked bureaucracy at the federal level and stimulated states and municipalities to do the same at their levels. However, exemption of federal taxes only touched the upper part of the bureaucratic iceberg. State tax on circulation of goods remained a serious hindrance in the life of small companies. The same remains true with respect to social security contributions and excessive requirements imposed in connection with a grant of official loans.

Our original statute of microenterprises contemplated an amendment to the constitution whereby microenterprises or family enterprises, would become municipal entities with no submission whatsoever to federal and state rules. However, it became evident that such an amendment would encounter unsurmountable opposition from federal and state authorities, particularly the tax authorities.

By the end of 1983, time was running short, and my only alternative was to seek a compromise solution consisting of two separate bills. The first was to establish special legal treatment of microenterprises in the areas of taxation, social security, labor obligations and official credit facilities. The other bill was to authorize states to exempt small companies from tax on circulation of goods.

The extensive use of the media and spontaneous popular, political and institutional support converted the statute of microenterprises into a major political and economic issue. The two bills were unanimously approved by the Congress in spite of resistance by virtually all state secretaries of finance.

One of the limitations of a program like this is that we are a federal system. Several provisions of the statute were not dependent on regulatory action of the government at all levels. Yet we felt that the statute would have one political effect: it would break through the rigidity of formalism and bureaucratic resistance.

It should be noted that prior to the debureaucratization program, small companies had virtually no political representation. Today, in most states, there are associations of small enterprises capable of presenting their claims and defending their interests before the government on all three levels and in the Congress as well.

One evidence of the political and cultural impact of the statute is the introduction in the constitution, now being drafted in Brazil, of specific provisions assuring separate legal and administrative treatment to small business enterprises. These provisions would have been unthinkable five years ago.

Of course, the statute is not a finished work of legislative art. On the contrary, it has defects and omissions; it must be perfected and, like any legislation dealing with economics, it is subject to constant alterations. Nevertheless, it stands as a symbol and a landmark of modernization in Brazil.

Over the last two-and-a-half years since the statute has been enacted, 1.5 million new companies were organized or re-applied as microenterprises. This year, in spite of the

severe economic problems the country is facing, 250,000 new microenterprises have been created. It's not possible to state how many of these companies have succeeded or survived, but it's a strong indication of the need for differentiated legal treatment of small companies.

One final remark: In Brazil, we clearly elected to reduce the cost of legalization so as to reduce the size of the informal economy. We believe that the benefits of legalization, or formality, should be extended to everybody and thereby keep the size of the informal economy within natural limits.

Luis Eduardo Magalhaes

Mr. Luis Eduardo Magalhaes is a board member of the Chambers of Commerce of Sao Paulo, Brazil, as well as director of two private firms doing business in real estate and farming. He serves on the board of directors of Credit Commercial de France, Banco de Investimento Brazil, the United World College, Sao Paulo Chamber of Commerce and the Brazilian Association of Sales and Marketing executives.

An informal economy exists in all countries and all systems to a greater or lesser extent. It seems, however, that it is most significant in countries where the costs of formalization are higher, whether in bureaucratic or tax terms.

Though many individuals are active in the informal sector by choice, either because they are opposed to any type of control or because of the temporary nature of their activities, there are also a large number of individuals who keep their business informal because they would not be viable if they were to meet all bureaucratic and fiscal obligations. The majority of the latter wish to formalize because informality too has its costs. The greatest of these is the impediment to growth posed by limited access to the banking system and even to many potential clients and suppliers. Vulnerability to the tax man is also an important cost. Evidence of the majority's desire to formalize its businesses in Brazil came from the passing of the microenterprise statute, which, although it cut through only some of the red tape and removed only part of the tax load, led to the formalization of a large number of small businesses.

The data about the labor force reveals the existence of a broad informal economy in Brazil, which some studies estimate to be 12 percent of the gross domestic product. A national home sample poll shows that of an economically active population of 55 million in 1985, a little more than half were informally employed: about 13 million in agriculture and

15 million in the cities.

Formal or partially formal small and microenterprises are a substantial proportion of existing business. Today, 70.6 percent of commercial firms have fewer than five employees; 63.2 percent of industries employ fewer than ten people, and 60.9 percent of the firms in the service sector have fewer than five employees.

In spite of this situation, Brazilian law, as a rule, treated all firms the same. The tax burden and bureaucratic requirements were established on the basis of the situation of the larger firms, and even for them, the requirements have been shown to be excessive. These taxes and rules were applied indiscriminately to small, medium and large enterprises.

The creation in 1979 of the Ministry of Debureaucratization was an important step in the struggle to simplify the lives of business people. At the same time, the Chambers of Commerce of Sao Paulo, together with other business groups, organized small business congresses in order to debate the problems of the small companies. A list of the main obstacles confronted by the smaller firms was drawn from these discussions to direct the action of the business organizations and help the Ministry of Debureaucratization in the struggle for a bill establishing fiscal and bureaucratic requirements for microenterprises and protecting them from the existing legislation. The points raised at these congresses included fiscal, credit, labor and social security problems as well as the ever increasing state interference in the market.

Starting from the diagnosis of small business' main problems, the Ministry of Debureaucratization and the business organizations tried to sensitize other sectors of the government and the national congress to the need to treat smaller businesses differently. The initial idea was to draft a bill to establish minimal fiscal and bureaucratic requirements, making small businesses immune to existing legislation. This ideal solution gave way to the more realistic solution of exempting them from some taxes and some bureaucratic requirements

The bill was greeted by the business organizations not as a solution to the problems of microenterprises but as a first step in that direction and, beyond that, as a first recognition by the government of the need to treat businesses differently according to their size. In spite of its limitations, the bill produced significant results in quantitative terms, as Dr. Piquet Carneiro mentioned: as much by the regularization of the situation of previously existing small businesses as by the creation or formalization of new firms. The costs of formalizing a firm are still very high and are a factor encouraging informality.

The duties on payment of labor are especially important in inhibiting formalization and employment-generation. This explains in part the existence of a large contingent of unregistered employees. Of three million businesses registered with the social security system, about two million declare they do not have any employees. Comparison of this data with those of the national home sample poll on unregistered workers leads one inevitably to suppose that many firms which declare that they have no employees actually employ people without registering them and that many other firms do not register all of their employees.

Two years after the bill's adoption, the following main criticisms can be listed. The bill did not consolidate microenterprises' obligations but only created some exemptions, requiring small businessmen to track all of the national, state and local legislation. The bill extended the net sales limit requirement to 10,000 OTNs (Obrigacoes do Tesouro Nacional, or National Treasury Bonds), the equivalent of about U.S. \$33,000. Thus, only very, very small businesses can benefit from the bill. The inapplicability of the bill to small businesses whose sales surpass the 10,000 OTN limit is a disincentive to growth and complete accounting for sales.

Nevertheless, the microenterprise statute was an important achievement for the entrepreneurial class. This bill established simplified bureaucratic procedures and some fiscal exemptions for small businesses. Lines of credit were created specifically for them. CEBRAE, the Brazilian support system for small and medium-sized firms, along with business associations like ours, has sought to offer advice, help with fiscal and accounting problems, orientation to new techniques and directions for business.

However, the benefits of the small business bill are limited and apply only to the smallest enterprises. The credit lines never have sufficient funds, especially in periods of economic contraction. The loans are of very short term, and there are still problems of lack of guarantees. Unfortunately, efforts by CEBRAE and the business associations are not enough to meet the needs of the bulk of small firms. And if these problems were not enough, small businesses face extra difficulties because of high inflation rates and stabilization programs to which are added frequent changes in economic policy.

In spite of this web of problems, small and microenterprises and the informal sector in Brazil have an important role in the Brazilian economy -- not only by their number and the number of jobs they represent but because of their geographical and sectoral spread.

Starting from this microenterprise statute, more complete legislation could be drafted to favor small businesses, assuring them equality of opportunity and competition through regulations based on their characteristics, possibilities and needs. The draft constitution being debated in the country contains the principle of differentiated treatment for small businesses, which will undoubtedly ease the drafting of a new bill with broader benefits.

The debates on the bill helped to show the politicians and the society as a whole the importance of small business - not only for the economy but also for social stability. It created a consciousness that the market economy, based on small businesses, is the best way to make economic development compatible with political liberty.

Dr. Edward Hudgins

The discussant for the panel was Edward Hudgins, who received his Ph.D. in political theory at American University and his bachelor's from the University of Maryland. He is a fellow at the Heritage Foundation and director of the Center for International Economic Growth.

As Hernando de Soto has noted, we are in a situation today, in terms of economic development, similar to the situation that existed in the late 1700s and the early 1800s. At that time, you had in the United States, in Great Britain and on the continent of Europe a rising class of entrepreneurs, individuals whose wealth was based on their own efforts, on their own hard work and on their own innovation. You had opposing them a privileged elite who held political power based to a large extent on birth and family connections and who held economic power based to a large extent on state monopolies and various mercantilist restrictions.

At that time, the revolutionaries and the reformers were those who opposed the vested interests in the name of the common people, those who promoted economic freedom, understood basically as the rights of private property, and those who promoted political participation and accountability of the rulers to the people. In a sense, when we face Third World development situations today, we're in a very similar situation as we were several hundred years ago. We can make the same arguments and apply the lessons of several hundred years ago, I think, to the situation today.

We have discussed some of the particular economic means by which we go about reform, by which we try to break

the system of interest groups. I simply want to focus on two of the aspects that have been brought up here. The first is the importance of rhetoric: that is, the importance of how to advance the debate within a particular country. Rhetoric and debate are important because, first of all, it explains to people the nature of a problem. It educates them in terms of how to change and reform a situation. Perhaps just as important, it inspires people, both the elite as well as the common people, to understand that they don't have to exist in the situation as it is, that poverty is not their necessary and predestined role in life.

I think that a very important function of the rhetoric you use in the discussions in your countries is not only to educate but to inspire people, to show them that their actions can indeed have consequences. The use of rhetoric must be applied to each country individually. In some cases, perhaps the case of Paraguay, you have to be careful about appearing too radical. You have to appear reasonable; you have to be, as it were, a Fabian capitalist, just as you had Fabian socialists in Britain in the last century.

In other countries, again, a more radical approach, where the rhetoric indeed will be stronger might be appropriate. It will be a rhetoric of: "We stand for the rights of the people. We stand for the rights of the poor, the opportunity of the poor to advance. It is the ruling elites, the privileged, who are creating the problems and are keeping people in their poor situation."

Again, the question of how to apply it would depend on each particular country. You have to avoid, for example, misunderstandings of terminology, as Hernando de Soto pointed out. In many countries, "private" in the sense of private enterprise does not mean a free market system; it means privileges; it means businesses existing with government subsidies, with trade protection and so on. So you have to tailor the rhetoric to your country.

But I think in the end you're going to have to appeal to the self-consciousness of the people. You're going to have to show them where their real interests lie. Remember: The Marxists often appeal to envy; that's part of the way they gain power. I think in our rhetoric we have to turn it around and appeal to that other side of human nature that's opposed to envy, and that is pride or self-esteem. We have to say to people, "Look, you can do it too." People in Peru come to the cities from the countryside. They don't have college degrees, yet they make it in the informal sector against all odds.

There is also the need for education. I mean education on two levels -- first of all, of elite groups. And when I say

“elite groups” I don’t mean necessarily the people in power. They’re probably not going to listen anyway. I mean community leaders, leaders at the local level and students. This is, I think, another very important aspect. You have to keep in touch with your grassroots members. You have to use the media whenever possible to bring out ideas, to at least start a debate. Because if you start talking about the issues, in the end, you will win.

Just in summary, I believe that ideas do have consequences. Economic reforms, as we have discussed, are important and indeed at the basis of the elimination of poverty. But an important part of the battle is going to be the battle for ideas, the battles for the hearts and the minds of the people.

We have succeeded in the United States, in Western Europe and in other countries. I don’t see why it has to stop there. I think that this is a revolution that eventually is destined to sweep the world.

PART V

BUILDING GRASSROOTS CONSTITUENCIES FOR ECONOMIC CHANGE: REPLICATION

- Moderator:*** Juan Bendfeldt, Center for Economic and Social Studies, Guatemala
- Tunisia Moncef Bouchrara, Ideas and Communications
- Kenya Dr. I. Onyango, Ministry of National Planning and Development
- South Africa Japie Moropa, Get Ahead Foundation
- Venezuela Jesus Eduardo Rodriguez, Institute for Liberty and Democracy/Venezuela
- Discussant:*** Helen Soos, Private Sector Office, African Bureau, U.S. Agency for International Development

The panel had the task of assessing the potential for replication of the Latin American advocacy programs in other countries. The panel was moderated by Dr. Juan Fernando Bendfeldt, director of the Center for Economic and Social Studies in Guatemala, professor of economics and ethics at the Francisco Marroquin University and director of studies at the Guatemala Development Foundation. He is a member of the board of Francisco Marroquin University and the Guatemala Development Foundation. Dr. Bendfeldt is the author of numerous publications and is a columnist whose byline appears regularly in Prensa Libre.

Juan Fernando Bendfeldt

I have asked the panelists this morning to respond to the following question: Is the informal economy strictly a Latin American phenomenon, or does it have pretty much a universal character, wherever certain conditions seem to appear?

I will add only one example of my experience in the informal sector of Guatemala. Guatemala City has a population of close to two million and anyone who lives in a big city can probably imagine the amount of trash and refuse that accumulates from day-to-day.

Well, Guatemala City is quite a peculiar case. The entire trash collection system of Guatemala City is informal. Most of the vehicles used are privately-owned, discarded old vehicles that cannot meet the traffic regulations. The owner of the vehicle usually drives it, and you see two or three workers hanging on the trucks that go to each house, for a very low cost, every day to pick up the trash.

These workers receive no salary. They have only, as remuneration for their work, the right to sort through the garbage once they get to the city dump. By all our estimates, they make more money this way than by receiving minimum wage. As a result, we have perhaps the most efficient system of recycling trash very inexpensively. The trash is classified and then reintroduced into the formal economy.

The trash collection system is the major supplier of the paper industry in Guatemala. It makes cartons and other industrial types of paper, plastics and glass for glass containers. So, in general, you see it is not just the little guys but a very complex network: a complete spontaneous order, very sophisticated, very efficient.

It is not anarchic, but it is not due to the Office of City Planning Bureau that this system is working so efficiently. This is basically, a free, unhampered market. With that in mind, perhaps our basic policy objective should be to advance proposals that tend to go in that direction -- the liberation of the market -- and in no other direction.

Moncef Bouchrara

Moncef Bouchrara is a civil engineer by profession, with degrees from the University of Paris. He formed his own consulting firm in 1977 and is also founder and president of another company, Ideas and Communications, established in 1987. He has taught for

the last ten years in the School of Engineers of Tunis and now teaches in the School of Architecture as well. He has organized numerous seminars on the informal sector and this year held the first trade fair on indigenous innovation and a symposium on "The Informal Sector, Rampant Industrialization and Diffuse Economy."

Ladies and gentlemen, it is my pleasure to address you today not only as a Tunisian but also as an entrepreneur.

Tunisia is a North African nation of eight million inhabitants and was a French colony until 1956. Tunisia has gone through three stages. The first stage, until the beginning of the 1960s was the building of the state. Second, the socialist experience lasted through the 1960's and has now been popularly rejected. The third stage was the so-called liberal policy of the 1970s.

During the 1970s, the state led an ambitious policy of industrialization, heavily subsidized with, let's say, a very Western point of view of how it should be implemented. As we discover, today, that type of industrialization suffers, especially within the public sector, from inefficiency, over-investment and high rigidity.

But over the years, an informal vigorous Tunisian sector grew in competition, but also in cooperation, with official industry. Part of this informal sector arose as a second, hidden industrialization. It has a great ability to develop systems of production, with little capital, but with wonderful, enormous ingenuity. The reality is that the informal sector represents an integrated economic structure with enough internal rationality to have significant control of the development process of my country.

I probably would facilitate the discussion if I give you an example of the dimension of the informal sector. I am going to release a state secret: Tunisia is probably beating the world record in building houses per capita and per year. The government is very proud to announce that Tunisia every year is producing 40,000 modern dwellings with modern building materials, and that is a very respectable figure for developing countries. It represents five dwellings per year per 1,000 inhabitants.

In fact, the figures show that it is probably 80,000 dwellings per year. This figure is a world record. In fact, this point is astonishing because only 20 percent to 25 percent of production is by big companies, especially state companies. Seventy-five percent is due to the diffuse economy in domestic construction. Tunisia is not an urban anarchy; these dwellings are viable and constitute an accumulation of capital on a large demographic basis enabling families, in ten years, to finance

the son who wants to set up his own microenterprise.

Let me tell you about the brick industry that I have studied closely. In 1972, Tunisia produced 300,000 tons of bricks, three-fourths by two state companies and a quarter of it in the informal sector. Twelve or 13 years later, this production has been multiplied by ten. The state companies represent only 15 percent of production; the private industrial companies represent 60 percent, using imported technology and subsidized investment. What is most surprising is that a quarter of the market is within the hands of the informal sector, 150 small entrepreneurs all around the country.

Another example is the shoe-making industry. Tunisia, we believe, is producing 20 million pairs of shoes. Half are produced by the informal sector and sold on the market with fierce competition from heavily subsidized industry.

Mr. Bendfeldt, for example, had been speaking about what we would call the trash economy in Guatemala. What is interesting to know is that the trash economy, which probably exists in all of our countries, is not a dispersed economy, even if it is diffuse. You discover, if you take the time to look, a very dense network.

We are here to identify practical tactics to promote that large target group of popular entrepreneurship. I personally, as a modest private actor, have identified at least three ways: First, is the work that de Soto has done so well in his country by identifying the legal barriers that forbid a small producer to enter a sector.

The second way is changing the image of indigenous entrepreneurship in our countries through a strategy which I would call a capillary communication action: pushing journalists to speak about vivid examples, creating new heroes. If you go to any of our countries, ask for the newspapers; the first pages are on political matters, and the three last pages are about sports; one page is about singers. When you have that type of structural information and you ask your son, "What would you like to become?", he answers immediately, "I want to become a minister or a soccer champion."

The third way to promote the informal sector, I believe, is to find a global explanation of the bias between the regulations and rules and the reality of popular entrepreneurship in our countries.

Our regulations come from the colonial period. At that time, the view of the Muslim or of indigenous people was that they couldn't be considered as a source of economic wealth. The indigenous societies by themselves were not

considered as a source of industrialization, economic growth or technical change. I believe that is why we have to explain that our societies, our people, as they are, whether illiterate or not, are wonderful entrepreneurs.

Dr. I. Onyango

Dr. I. Onyango has a Ph.D. in labor economics. He is the principal economist at the Ministry of Planning and National Development in the Republic of Kenya. He is the head of the informal sector unit at the Ministry of Planning and a member of the Task Force on the Informal Sector in the Republic of Kenya. He is a former research fellow in the Department of Business Studies at the University of Edinburgh.

Ladies and gentlemen, it is my pleasure to present my paper on the informal sector in Kenya. In my presentation, I am going to talk about policy issues, strategies and the constraints. I will try to answer three questions: first, why are we, in the government in Kenya, interested in this very important sector; second, what are we doing to mobilize the resources of the informal sector; and finally, what are the constraints?

Kenya's population today is about 22 million people. In the year 2000, which is about 13 years away, this is projected to rise to about 35 million people. This will be 78 percent more than we had in 1984. Of these 22 million people, 14 million will comprise members of the work force, and nine million people — that is about 25 percent — will be living in urban areas.

Three basic issues arise from this phenomenon: first, what are these people going to eat; second, where are they going to work; and third, where are they going to get shelter? In addressing these three issues, the Kenyan government has published a policy document that is going to guide our development planning to the year 2000. The document has seven chapters, and we have devoted a whole chapter to the informal sector.

In this development strategy, agriculture continues to remain the mainstay of the Kenyan economy. To stimulate agricultural production, small-scale, agro-based industries -- basically in the informal sector -- should be promoted close to the rural areas where 80 percent of the Kenyan population lives. The growth of these enterprises is considered important because they produce the basic inputs required by small-scale farmers: farm tools, machinery equipment, chemicals, services. Increased farm incomes will increase other demands for

small-scale products and, thereby, stimulate their growth. The informal sector enterprises, located in the rural areas, also provide employment opportunities for the rural population.

The informal sector enterprises are also important in another respect. We have to create employment opportunities for ten million people ten years from now. The formal sector requires some \$20,000 to create one job. That is a lot of money, given the resources at the disposal of the Kenyan government. However, the corresponding job created in the informal sector costs less than \$5,000. This suggests that if we have to make an impact in terms of employment creation, more attention should be put on the informal sector.

Our average rate of investment today is about 25 percent of gross domestic product, which is a reasonably high level by any standards. If we maintain this level to the year 2000, we shall only be able to create 1.4 million jobs. If we add those to the 1.5 million that we have at the moment in the formal sector, the economy will have only three million jobs for a labor pool of 14 million. Where is the surplus -- that is, 11 million -- going to be employed? To accommodate these people requires the creation of 900,000 jobs per year from 1984 to the year 2000. If we have to make an impact on employment for the labor pool, resources have to be invested in the informal sector.

It is estimated that the informal sector in Kenya today employs about 40 percent of the work force in the urban areas. Sixty percent of shelter in the urban areas is generated by the informal sector, and up to 80 percent of transportation in the urban areas is in the informal sector. With these considerations, we are persuaded that the informal sector is a key factor in development to the year 2000.

Between November 1985 and June of last year, we held a series of six national conferences, discussing the subject of the informal sector. The idea was to create an awareness within the government, among scholars and within the business community on government intentions about mobilizing this sector. During these conferences, it was made clear by the government that the informal sector is no longer a collection of illegal activities.

Further, in last year's policy paper, the government said it was going to establish a special unit on the informal sector whose duties were to coordinate all activities related to the informal sector in order to ensure that they receive their due emphasis in development planning. This unit was formed in March of this year, and I am attending this conference as head of that unit.

In the same documents, the government said it was going to establish a special task force charged with the responsibility of reviewing all policies, particularly local authority and municipal authorities' bylaws that tend to impede the operation of this sector. This special task force was formed in April of this year; the report is ready and could be submitted to government any time now. The task force had the responsibility of going through all the policies, quite a number of which have been rather prohibitive to the smooth operation of the informal sector.

This financial year, '87 through '88, the government has provided an allocation of U.S. \$12.5 million for construction of infrastructure facilities to assist the informal sector, particularly in designated small towns in the rural areas. In a few places, some of this infrastructure, in the form of sheds, has been completed. The idea is for the sheds to have water and electricity to mobilize this sector.

Tax incentives are being offered today. If the informal sector operator opens a business in the rural areas, he is exempted from duty to the tune of 60 percent of his gross profit. If he imports raw material from outside, most will be duty-free.

The government, in collaboration with aid donors and the Kenya Commercial Bank, is operating an informal sector pilot scheme. The idea is to provide lessons on how to give credit facilities, without necessarily requiring collateral security.

The Ministry of Industry is compiling a booklet aimed at educating the public, particularly the informal sector operators, on assistance programs that are available from government and how they can benefit.

Let me conclude by briefly talking about some of the constraints that we are facing. The data base is very weak. Some work has been done on the informal sector, but it is mainly based on urban areas. Most of these studies are uncoordinated, and my Informal Sector Unit is, at the moment, trying to take an inventory of what has been done to identify gaps for further research.

Further, most informal sector artisans are very skilled people. Although they have very useful skills, they are lacking in complementary commercial skills. You will find that most of these businesses do not last more than five years. Although they have the artisan skills, they are deficient in commercial skills such as business management, marketing and accounting. Measures are being taken now, in collaboration with donor institutions, to impart some of these skills to make these artisans more versatile in the market.

Finally, marketing seems to be another problem area. Most of our programs seem to emphasize the supply side. But we are saying, "What can be done after these people produce?" Last Sunday, my colleagues in the Kenyan delegation and I had the privilege of having dinner with the Friends of Kenya organization here in Washington. When we went there, what did we find? The informal products are selling in the streets of Washington: that is how dynamic the informal sector is in Kenya's economy.

I would like to conclude by saying that the government of Kenya recognizes the great potential that is inherent in this sector and, currently every effort is being made to mobilize and exploit this potential. The major constraint, as I see it, is that of financial resources, but the will is there; the push is there, and we are convinced that we are moving in the right direction

Japie Moropa

Mr. Moropa is deputy managing director of the Get Ahead Foundation in South Africa. He has degrees in personnel management from the University of South Africa and in community development and financial management. Before joining the foundation, Mr. Moropa was a training officer at the Corporation for Economic Development and taught accounting. He is also a member of the Match Maker Fair Committee of the American Chamber of Commerce in South Africa and on the Advisory Committee of Small Business of Reverend Leon Sullivan's signatory companies in South Africa.

Briefly, our company, the Get Ahead Foundation, is a black-owned and directed company. Our chairman is Dr. Motlana, who is also chairman of the Soweto Civic Association. Other board members include Archbishop Desmond Tutu.

Our objectives are to develop the communal and business interests of blacks in South Africa. We do so in a number of ways. First, since we have a very high unemployment rate in our country, we have started a micro-loan scheme where we will lend up to \$150 to enable people to get started in business in the informal sector. Second, we have a larger lending scheme of up to \$5,000 to help people become backyard operators or informal sector entrepreneurs. Third, we have a very active mentoring or counselling program with international executives who have now come to South Africa. Finally, we organize seminars on marketing, bookkeeping and trade skills essential to our disadvantaged people.

We have been recognized as being the only organization in the country that is totally immersed in informal sector development. We have also been described as being the most effective community-based organization. We are, in fact, a grass roots organization. However, everything that we do is illegal because we are developing the informal sector. This means that we have to break laws, regulations, bureaucratic practices and business rules as well as apartheid laws.

Let me describe the case of a street vendor selling fruit or vegetables or shoe laces. She is the sole breadwinner for her family. Whatever she can earn through this small business is used to buy food and to provide shelter and school books or fees for her own children.

However, the law says that if she does obtain a license, she must act decorously. She may be illiterate or semiliterate, and yet, she is presented with a 23-page document that lists the street vendors' regulations. If she sells newspapers, she must then stand one yard in front of the street corner and occupy a certain area. Her newspaper stack may only be of a certain height. If she is a mobile vendor, the regulations say that she must sell her goods at one place for one hour. At the expiration of the hour, she is then obliged to move on to another area 100 yards away. There she may trade for one hour, but when that hour elapses, she is then obliged to move on to yet another area which is, again, 100 yards away but is not the same as any area previously occupied by her for that day. If she is found by the authorities to be in breach of either the time factor or the distance factor, she is then officially prosecuted. A summons against her is issued.

By the way, in the course of our discussions over the last few days, one has heard references to informal markets or trading markets. In South Africa, our laws and regulations do not permit this to happen. Yet we at Get Ahead have started building these unofficially or illegally. Perhaps the best illustration is that of Cross Roads in the Cape area. We built an informal market for the people there which has blossomed to the extent that it is now the central business district in that area. Thus, economic change has been brought about by a bold step.

The laws of the country are such that we are totally overlegislated. These laws and practices prohibit economic development and change. Two years ago, the parliament passed the state president's Deregulatory Act that authorized the state president to suspend any law or regulation which prohibited economic development. To date, no law or regulation has been suspended.

There are many laws which militate against a black business person. These are specifically aimed at keeping the

black people out of the economy. Let me give you some examples. First, the Community Development Act, Section 43, states that no license to trade in a white area shall be given to a black person. Thus, by law, licenses to do business are prohibited. I am happy to tell you that we are starting to overcome this by arranging for whites to act as nominees.

Second, our Group Areas Act specifically prohibits black people from owning or renting property in areas of their choice. Thus, they are denied geographical mobility and ability to choose location.

Third, the Land Act of 1913 denies us the right to hold direct title. Our organization, Get Ahead, has become widely known in South Africa for its willingness to act as a nominee or front for any black person who wants to occupy a business or dwelling house in a white area. We have fronted for hair salons, fast food outlets, craft shops and others. The attitude of our board is that people should not be denied access to the economy purely because of the color of their skin. Thus, by giving a lead to the people, we are bringing about a practical change.

Apart from these regulations and laws, bureaucrats are also given immense powers. Thus, they may swoop on our lady vendor and, by law, confiscate the goods and destroy them immediately. However, there is mounting opposition to this, and a classic case recently was that of two shoeshine boys removed by the security people from the front of the stock exchange building in Johannesburg. Fortunately, the press and members of the stock exchange protested so much that they have been reinstated, despite the fact that they trade illegally. Thus, the informal sector has been able to bring about a certain amount of economic change.

There is no doubt that our business world is totally rigid and unsupportive of the informal sector operators. Merely as an illustration, our banks and First World lending institutions require collateral in the form of property ownership or two years trading figures for a loan. Our disadvantaged people are not able to own property, and, more often than not, they have not been able to trade and, hence, be in a position to produce two years of trading figures.

However, change is occurring. In the transport sector, for instance, we have observed a considerable blossoming of the informal operators. Many may be licensed, but recognition is now being given to a great percentage which are not licensed and are purely informal operators. For the first time, they are able to obtain credit merely to carry on business.

Further, a well-known building society which lends money to home builders has changed its policy towards the

informal sector. Our black people are bound by law to live in townships like Soweto. These townships are very crowded: ten people or more living in a small four-room house, the matchbox house. To meet the housing demand, people are building garages for occupancy at a rent at \$50 per month. The building society has recognized this trend and grants loans for these buildings.

What saddens us in our country is that we hear of other countries speaking of 60 percent of the work force being employed in the informal sector or that the underground economy accounts for 60 percent to 80 percent of the GDP. Tragically, this is not yet the case in our country. One of our financial journals said that our informal sector accounts for only 5 percent of the GDP. What a lovely challenge for the future to Get Ahead! Can you imagine us trying to catch up with the rest of you seen in this hall today?

However, from the black political point of view, you should also be aware that our leaders are starting to say that the flip side to political power is economic power. Our own chairman, Dr. Motlana, is encouraging people to become involved in earning money. He urges them to get into the informal sector. He is saying that in a post-apartheid society, our people must want to earn money, instead of begging for it. He is, thus, suggesting a system based on free enterprise — we do not use the word “capitalism” because this is equated with apartheid in South Africa. Rather, we use the expression “free enterprise” because it carries with it the connotation that the economy will be freed and our disadvantaged people put in a position of being able to participate freely and enjoy the benefits of their labors.

Jesus Eduardo Rodriguez

Jesus Eduardo Rodriguez is a member of the board of directors of the Caracas Chamber of Commerce in Venezuela. Mr. Rodriguez is also founder and vice president of Cedice, founder and director of the Institute for Liberty and Democracy, Venezuela, and director of several business organizations. He received his university degrees from the University of Michigan and Stanford. His most recent publications include a measurement of the Venezuelan informal sector.

I would like to begin by mapping out some of the thoughts or concepts that have been mentioned during these last two days. What I am going to say today is the result of five years of work done in Venezuela with the help of more than 100 entrepreneurs, people from all levels of the private sector in

Venezuela.

In Venezuela, more than 47 percent of the work force is employed by the informal sector. We have found that more than 32 percent of the non-oil GNP is produced by these informal entrepreneurs.

Informality has been seen as a revolution. I would say that the informal revolution is simply the answer to the control of our societies by people who base their actions on an ideology or culture of the left. This collectivist ideology has eliminated legal, political and economic institutions which promote development and guarantee the basic human rights of life, liberty and property. The absence of social structures which promote the human being as the center of the society is the basic cause of the underdevelopment of Latin American countries and most countries in the world.

The political sector has gradually created a public administration of tremendous magnitude. In Venezuela, by 1984, there existed more than 500 state-owned corporations in all economic sectors. In the early 1960s, the state-owned corporations absorbed 25 percent of the consolidated public budget; by the beginning of the 1980s this proportion had grown to more than 75 percent.

These corporations have become huge populist and clientist mechanisms for the political parties and other organized sectors who obtain enormous resources from the state. They have served, instead, to increase the antagonism between capital and labor and have not promoted the complementarity that should exist between the private and public sectors. The intervention of the state has gradually reduced the size of the civil society and increased the participation of the political sector in all aspects of social life. This progressive statization has diminished formal private initiative and has generated more bureaucracy, inefficiency and corruption.

In the legislative area, the influence of this leftist ideology is even more pervasive. Laws are generated by the executive branch and not from the legislative, contravening the constitutional order and destroying the economy. In Venezuela, these decrees and laws have increased bureaucracy from 300,000 public servants in 1972 to more than 1.5 million in 1984. The economy is managed by these employees of the executive branch who determine, for example, who can invest, who is granted a license to import goods, who benefits from subsidies or exonerations. Under this climate of legal insecurity, there exists a lack of faith for new investments and, hence, for creation of new jobs.

The human being, who is basically ingenious, has

found a way to survive. Based on fundamental ethical values and following the common law, he has developed what we call today the informal sector, which is a sort of primitive capitalism and, at the same time, the genesis of individual initiative.

There are many solutions. In the case of Venezuela, we think that there are three main points. First, in the political system we have to increase the amount and level of political information available to the common citizen.

We have to promote personal initiative, as opposed to state paternalism, and we have to foster motivation for achievement. The same political order will have to balance the judicial sector with the executive one, taking the political parties out of the judicial sector to make the administration of justice more efficient. We have to rescue the judicial system so that the civil society may demand its rights from the public sector.

In the economic order, we think that it is very important to promote private initiative as a natural and efficient job generator. We have to educate the average citizen on his rights and duties so that his products improve in quality and so that he will be able to defend his rights. We have to search for means to increase the productivity of microenterprises. We have to fight for the removal of limitations imposed on productive entrepreneurial activities that remove privileges. We have to fight for real and fair competition between producers so that anyone may enter and remain within a specific market.

Within the social order, we think that it is important to promote active participation of all members of society: consumers and producers. Something else that we have found important in Venezuela is the fight against conformism.

As a final word, let the informals work in their sane environment. Do not contaminate them with our overregulated world and try to approach them to develop a better society. Thank you.

Helen Soos

The discussant for the panel was Ms. Helen Soos. She graduated from Radford College with honors in international relations and obtained a Master of Arts in international economic development from the Fletcher School of Law and Diplomacy. Ms. Soos has been with AID for 12 years. She has most recently served as director of African Affairs with the National Security Council in the White House. She has spent over ten years in Bolivia, Central America and East and West Africa and has worked in more than 30 developing countries.

The turnout at this conference reflects the extraordinary response that people are feeling to these ideas. In my Peace Corps days in West Africa, I often heard the term "je suis petit capitaliste," "I am a petty capitalist;" people were very proud of their entrepreneurial spirit. In fact, trading has been part of the history of Africa for thousands of years reflecting the human entrepreneurial spirit. It is important to promote this petty capitalism, this informal sector, because it is one of the few sources of growth in these economies. This growth occurs at the grassroots level where it is most needed to meet a great variety of basic goods and services.

Another reason for the response to this conference is the inherent distress and antipathy for bureaucratic society which seems to be sweeping the world. Max Weber was correct in his analysis that bureaucracies have an inherent tendency to perpetuate themselves. They perpetuate power by creating new rules. They have the capacity to mushroom into structures and processes that no rational human being would ever create or condone. For a bureaucracy, rules and red tape become an avenue to power and an opportunity for corruption.

Now, I would like to propose three steps to build constituencies for broad-based economic participation that will help resolve the issues of poverty in the Third World. First is consciousness-building: understanding and creating an awareness of these issues. The research that has been done in Peru is not only an inspiration to all of us, but represents a very significant step in encouraging the kind of dialogue that we have had here.

A second step in building a constituency is to promote and expand policy dialogue into these areas. While some areas of policy issues which affect grassroots development have largely been ignored by the donors and by many governments, there are some which, at least technically, should be palatable for discussion. Property laws, the ability to acquire and defend property, should be entered into the spectrum of policy dialogue, as should tort laws which help to control the private sector. However, as long as the private sector consists mostly of the political elite or has close alignments, it may be difficult to introduce tort laws.

In the foreign investment sphere, we have recognized that bureaucracy is onerous, and in some countries, such as Mauritius, one-stop investment centers have been created. Each of the six, seven, eight or 20 government agencies whose approval is needed for an investment in that country have offices in one central location, and a businessman can go and simply find out what the regulations are and meet them. This approach could be tried in the informal sector.

The third step is to promote economic pluralism without which there can be no constituency for challenging state power. State economic power must be challenged because it is inequitable and inefficient to a great degree. The pre-eminent role of the state must be counterbalanced to create the basis for compromise and to avoid abuse. There are many options for building economic pluralism. We have discussed the informal sector, but there are other options. Agricultural cooperatives, if left alone by governments, can create economies of scale for marketing or input supply. Another example is credit unions which can compete with banking sectors that simply don't reach the poor.

Finally, one last approach, which I consider to be an ideal in its impact on the informal sector is privatization. There is a desperate need to privatize state enterprises. However, it is always hard to find a good buyer. Private buyers are often foreign investors who, politically, are not acceptable, or the local economic elite might invest, which is sometimes equivalent to crony capitalism. Neither of these options is very appealing. The alternative that I propose here is called "The Employees Stock Ownership Plan." In terms of efficiency, it has proven to be rather remarkable.

For example, the La Perla coffee plantation in northern Guatemala was besieged by communist guerrillas who killed the owner. The owner's son discussed with the peasants how they could defend the plantation. The peasants agreed to give up a part of their salary to purchase weapons in return for a share of the stock. Production has increased by 300 percent. Recently, the Economic Commission for Latin America adopted a resolution which was unanimously approved for Latin America, including Nicaragua and Cuba, to explore employee stock ownership as a road to privatization.

I would like to close with the thought that it is important to continue to stress the connection that exists between economic and political stability. The ultimate defense of democracy is a stable political and economic system that can meet the basic economic and political needs of all the people. Economic and social justice, reflected in broad-based ownership and participation is the best and perhaps the only viable long-term recipe for peace and prosperity.

Discussion

Given the role of the Kenyan government in promoting the informal sector, Dr. Onyango was asked to describe the factors leading the government to take this initiative.

Dr. Onyango indicated that the emergence of the informal sector is a response to the failure of the formal sector to satisfy the needs of the population. The formal sector in Kenya is characterized by gross capacity underutilization because of high dependency on oil, high capital requirements and the need for skilled labor. Conversely, he noted that the informal sector uses local resources and has an advantage over the formal sector because it relies heavily on unskilled labor, which is an abundant resource. Dr. Onyango noted that, due to the rapid population growth rates and the need to create jobs, the government turned to the informal sector because it seems to respond better than the formal sector in the areas listed above.

Mr. Bouchrara was asked, "How does the Tunisian government deal with microentrepreneurs who do not operate in the formal sector of the economy? What do they do to the illegals that are caught?"

Mr. Bouchrara indicated that in Tunisia there is a political tradition of pragmatism. Because of the closeness of the social ties, there is always a way of ignoring things and, when it becomes massive, of recognizing it very opportunistically. He also noted that in the last part of the year, the government had taken steps to recognize the informal sector simply because of the need to sustain economic growth.

All members of the panel were asked to respond to the following: "Is there a role that municipal governments, mayors, can play in trying to resolve this informal economy problem?"

Dr. Onyango responded by noting that they have a role in the sense that most of the local laws in Kenya seem to be in conflict with the current government policy of support for the informal sector. He noted that the government is trying to resolve these through a task force that is identifying what sort of reforms should be made. Dr. Onyango, however, felt that the informal sector is a fairly difficult group of people to deal with. They have developed their own system, and it may take time before a government like Kenya's really gains enough experience to deal with this group. For example, street vending

in Nairobi is prohibited, according to the existing laws. One way the government has tried to deal with this is to create markets, but most often the informals move out. As far as the informals are concerned, Dr. Onyango concluded, the market is better if they can sell in front of, say, government departments.

In South Africa, Mr. Moropa explained, the Get Ahead Foundation helped vendors to form organizations to approach the municipalities to try to avoid harassment and to convince the white municipalities to build informal markets. Instead of leaving these vendors to sell in the open, the informal markets give a sense of commitment. Because they have an association, he noted, they will clean that informal market and keep it very tidy, and the municipalities are responding very well to the idea.

Based on his experience in Guatemala City, Mr. Bendfeldt noted that there are about 21 official municipality-owned and sponsored markets throughout the city. But, in effect, none have been built in the last 25 years. As a result, as the city has grown, about 200 underground markets have appeared. Mr. Bendfeldt explained that the markets are a municipal monopoly leading to a situation where regulations, on one hand, prevent the formal sector from working but, on the other hand, do not provide municipal services.

Mr. Bendfeldt also provided an example of market liberalization on the municipal level. He noted that ten or fifteen years ago, the bus companies went on strike. While these buses were privately-owned, they were also overregulated, tax-exempt, and subsidized. The mayors' solution was to go on television and radio and tell everyone to start their own public transportation. All limitations were removed, and overnight there were trucks, school buses and private taxis taking the place of the bus system. Bendfeldt went on to explain that, after the bus strike failed, the mayors asked all the informals to go back home but they didn't. As a result, about 60 percent of the public transportation is provided by informals.

PART VI

EPILOGUE

The first International Conference on the Informal Sector demonstrated beyond doubt that the informal sector can be a source of fundamental political and economic change within Latin America. To a lesser extent, the conference also demonstrated that the informal sector phenomena is widespread throughout the Third World. However, the causes and implications of this phenomena will need to be explored systematically on a country-by-country basis in other regions to verify this finding.

Given the magnitude of the developing world's economic problems, there is a tremendous need to tap the entrepreneurial energy of the informal sector. The Third World debt crisis will continue to be a major constraint on economic growth in many countries in Latin America, Asia and, especially, Africa. According to the World Bank, many debtor countries are now experiencing a net outflow of funds and significant declines in per capita GDP. Under these conditions, countries must liberalize their economies in order to create new sources of economic growth. As Robert Litan noted in his comments, significant productivity gains and economic growth can be attained by removing the red tape barriers and deregulating the formal economy.

Over the next few years, the informal sector concept must move from the research to the implementation stage. The two panels on Building Grassroots Constituencies for Economic Change described a variety of advocacy programs and governmental efforts to attain these ends. However, much more needs to be done.

Speakers at the conference described a variety of policy and programmatic prescriptions to liberate the entrepreneurial energy of the informal sector. The following menu provides a summary of various proposals as a guide for development of action programs.³ Every country is different, of course, so the mix of policies and programs will have to be adapted to the individual country situations. Nevertheless, the following menu can act as a guide to decision-makers as they contemplate what steps to take.

Menu of Informal Sector Policy and Program Prescriptions

I. Deregulation

(A) Lower the barriers that discourage or prevent citizens from joining the formal private sector:

- * Eliminate many current licensing and titling procedures, and consolidate necessary requirements into a single procedure that can be completed in a single (one-stop) office.

(B) Reduce the unnecessary regulatory costs in the formal sector:

- * Require all new regulations to pass a cost/benefit test.
- * Require public hearings on all proposed regulations, with adequate time for comment and review.
- * Establish an ombudsman system to eliminate inefficient and burdensome regulations. (For examples of private and public systems, see presentations by H. de Soto and Dr. I. Onyango.)

II. Tax Reform

Simplify the reporting system for small firms, and provide exemptions for microentrepreneurs:

- * Eliminate record-keeping requirements, and provide tax exemptions for certain categories of microenterprises. (Brazil sets a ceiling of U.S. \$3,000 in annual gross income, but the level needs to be set depending upon conditions in each country.)
- * Collect taxes from informal sector enterprises through an annual assessment similar to a property tax (the assessment could be challenged by the entrepreneur if it is felt to be too high); this eliminates record-keeping burdens.

III. Access to Credit

Facilitate the flow of credit toward the most productive sectors of the economy:

- * Deregulate interest rates to increase savings and channel loans to informal firms already paying much higher rates.

- * Privatize the banking system (in many countries this is partially or totally controlled by government).

- * Support informal sector lending programs similar to those run by the Get Ahead Foundation of South Africa and the Paraguayan Foundation for Cooperation and Development.

IV. Economic Efficiency

Improve economic efficiency to encourage repatriation of flight capital, remove disincentives for productive investment and remove causes of dual economies in the Argentine model. (See M. Victorica's analysis).

- * Eliminate foreign exchange controls, especially the use of dual or multiple exchange rate systems.
- * Allow market-type mechanisms to allocate access to foreign exchange.
- * Phase out and eliminate price controls.
- * Reform the legal system to provide access to justice for informal and poor microentrepreneurs.
- * Introduce and/or strengthen laws prohibiting conflicts of interest.
- * Enact freedom of information laws requiring full public disclosure of legislative and executive branch decisions.

V. Education and Training

Improved education and training programs for informal entrepreneurs can help to improve business performance when coupled with policy reforms removing barriers and disincentives facing the informal sector:

- * Provide training and technical assistance through private and public agencies for existing informal entrepreneurs, including assistance to associations of informal entrepreneurs and support for national development foundations.
- * The private sector should encourage economic and entrepreneurial education as part of basic education programs.⁴

VI. Link the Formal and Informal Sectors

Organizations made up of informal sector entrepreneurs have emerged spontaneously in most countries as a result of the common need for defense against the government and, often, the private formal sector. Groups such as the Peruvian Young Towns Association, the numerous street vendor organizations, and others need to be assisted by and linked into the private sector organizations, to foster overall economic growth:

- * Provide legal recognition for informal sector organizations.
- * Create forums for the formal and informal sectors to work out their differences and formulate joint policy proposals. (See below for a description of a new initiative taken in Peru).
- * National development foundations and other groups assisting microenterprises should begin offering assistance to associations representing the informals and linking the formal and informal sectors. (See work done by the Paraguayan Foundation for Cooperation and Development, described by M. Burt.).

The above menu of policy and program prescriptions is directed toward decision-makers in the private and public sectors in the developing world. However, extending the concepts put forth by Robert Litan in his presentation, foreign assistance agencies and multilateral organizations should compare their efforts with the menu of choices to see whether such programs are providing the kind of assistance needed by the informal sector.

Recently, the Institute for Liberty and Democracy (ILD) of Peru developed a program that has the potential to integrate many of the policy and program prescriptions in the above menu. On February 14, 1988, the ILD announced the formation of the "Union Formal-Informal." A number of directors of the National Confederation of Private Business Organizations, the leading business association in Peru, joined with ILD to form the union. The following passage from ILD's announcement in *El Comercio* states the union's purposes:

"Therefore, we who make up this union are aware that the bold line bisecting Peruvian society is not the horizontal one dividing the entrepreneurs from the workers, where those above make themselves rich with the excess value earned from the poorly paid work of those below. No, for us the true dividing line in Peruvian society is, rather, a vertical frontier to the right of which one finds those politicians, bureaucrats and business-

men who profit and live off the state's favor, and to the left of which we, formal and informal producers, are located, with all our desire to produce, compete and progress in a market open to all. For this reason, we demand the elimination of that legal and political wall protecting some but not others. We want to make the transition from a conservative system that is impoverishing us all to a modern and prosperous democracy."

The union's purposes are to formalize and enhance the ILD's basic work as described by Hernando de Soto in his two presentations during the conference. As was further described in the ILD's announcement in *El Comercio*, the union has the following functions:

1. The elaboration of concrete proposals to carry out changes in the legal institutions of the country, to ensure that they function to benefit all citizens and, thus, to enlarge the present, narrow frontiers of formality.
2. To promote a system of voluntary work to provide legal advice to producers requiring it and to process and orient their requests.
3. To promote and defend economic rights through the reception of initiatives and complaints from formals and informals.
4. To design and develop projects in the social interest.

The challenge of the next decade will be to utilize private sector organizations, such as the Union, to mobilize the peoples of the developing world on behalf of change. While governmental efforts like those described by Dr. Piquet Carneiro in Brazil and Dr. Onyango in Kenya will play a vital role, the private sectors must awaken. It is the private sector that must form the constituency for change, and it is the private sector that must create the wealth so desperately needed in the developing world.

¹ *Transaction costs are those costs resulting from efforts to negotiate and implement agreements required for the exchange of goods and services and to combine the human and material resources needed to produce them. These costs include, but are not limited to, contracts, formation of businesses through law, permits, licenses and other legal instruments needed to do business.*

² *Everyone's balcony (El Balcon de Todos) - this is in distinction to the president's balcony, from which decrees and official statements are often made to the public.*

³ *Portions of the policy menu are drawn from "Internal Structural Reforms in Peru: A Promising Road Out of the Debt Crisis" by Robert Litan, Luis Morales-Bayro and Jorge Fernandez-Baca in the Journal of Economic Growth, Vol. 1, No. 2, (1986). The Journal is published by the National Chamber Foundation under a grant from CIPE and*

is available from the CIPE offices. The menu also draws upon an earlier review of the informal sector conducted for CIPE by ACCION International. The review was put out in a 1986 video report entitled "The Message of the Informal Sector" in Spanish and English. Copies of the video are available on a free loan basis from CIPE or on a rental/purchase basis from ACCION International, 1385 Cambridge Street, Cambridge, Massachusetts, 02139, USA (617) 492-4930. Video cassettes are \$18 rental, \$35 purchase.

⁴ *For example, COPARMEX, the Mexican Employers' Federation, has run a program called EMPRESA with the public vocational education system for the last several years. They have educated 60,000 students in the basics of business and economics at a cost of \$2.00 per student. Out of the 60,000 high school students, 2,000 have already gone on to start firms. Similar programs are underway in Argentina, Colombia, El Salvador, Panama and Uruguay, with a new venture being developed in Thailand. All of these programs are partially or totally supported by CIPE.*