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# **THE CRITICAL CONNECTION:**

**GOVERNMENTS, PRIVATE INSTITUTIONS,  
AND THE INFORMAL SECTOR  
IN LATIN AMERICA**

**Editors  
Katherine Stearns  
Maria Otero**



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**ACCION INTERNATIONAL**

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## **FOREWORD**

The informal sector has become an accepted part of the developing economies of Latin America. Instead of questioning the existence and economic viability of the sector, attention has focused on finding the most effective ways of promoting the growth and stability of microenterprises within the sector, so that they can create more jobs and contribute on a larger scale to economic progress. In most cases, non-governmental organizations (NGOs) were the first to address microenterprises with projects that offered training, credit, and technical assistance to relatively limited numbers of entrepreneurs. Programs initiated by the governments in the region were not far behind.

Since the mid 1980s, both NGOs and national governments have been actively involved in supporting microenterprises throughout Latin America. As the number of programs has multiplied, along with the scope and resources dedicated to many of those programs, the need for increased coordination and communication between governments and implementing organizations has become evident.

To share microenterprise program objectives and experiences within both the public and private sector, a five-day conference was held in Quito, Ecuador in November 1989 and attended by representatives of government agencies, non-governmental organizations and donors. In preparation for the conference, six

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country-specific studies (Colombia, Ecuador, Guatemala, Mexico, Paraguay, Peru) were prepared by a private consultant in each country. The studies examined efforts by the government and the NGO sector to work with microenterprises and served as a basis of discussion for the conference participants, who came from 13 Latin American countries, the United States, and Canada.

This document is an attempt to share the observations, findings, and concerns of that conference with a wider audience. The conference participants felt very strongly that effective programs, those that contribute on a significant scale to the development of the microenterprise sector, require substantial interaction between the public and private sectors. We hope that this document serves to encourage that communication and cooperation.

William Burrus  
Executive Director  
ACCION International

**PART I**  
**OVERVIEW**



## **THE ROLE OF GOVERNMENTS IN THE INFORMAL SECTOR**

Maria Otero

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### **EXECUTIVE SUMMARY**

The informal sector in Latin America represents a challenge and an opportunity of such magnitude that neither the public sector nor private development organizations alone can respond adequately. As the role of the *informales* receives increasing attention as a macroeconomic and social issue, both governments and private institutions will accelerate their efforts to assist tiny producers.

This overview summarizes the results of a five-day conference held in Quito, Ecuador in November 1989 which was attended by representatives of government agencies, private development organizations, and donors. These participants discussed the way in which state and private entities must operate to effectively reach the microenterprises with financial and non-financial assistance. The following conclusions and recommendations emerged from the conference and constitute a summary of its findings.

- The growth and development of microenterprises should be an indispensable ingredient of a country's national economic plan.
- Programs that reach the informal sector, whether conducted by private entities or by the government, will require a favorable environment in which to operate.

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- o Experience demonstrates that a government's approach to the informal sector must be integrated to include policy formulation, legal, and regulatory modifications and extend credit, training, and other services to this population.
- o As it develops an approach to the informal sector, the most useful role for government is that of an active collaborator, integrating other institutions into its national strategy. As such, the government assumes the task of formulating policy, affecting the regulatory environment, and providing both moral and financial support, to NGOs experienced in extension of services to microentrepreneurs.
- o Non-governmental organizations can play an important role as financial intermediaries in the implementation of microenterprise programs.

NGO microenterprise programs are an important mechanism to extend credit and training to informal sector producers and retailers, and should be incorporated into a national plan.

- o Strengthening the institutional capacity of non-governmental organizations is a key ingredient to the expansion of successful microenterprise programs.

- o Each donor organization must structure clear policies and strategies to assist the informal sector. In addition, donor organizations must take responsibility to assist governments to design their own programs and policies.

## INTRODUCTION

The growing presence of the informal sector in Latin American and Caribbean cities has presented a new challenge for governments as they enter the decade of the 90s. In almost every country issues related to the informal sector comprise part of the overall policy and development debate. As the informal sector grows, how will its role within the economy and society be perceived by the state? Are there currently strategies to integrate this sector into the broader economy or is the tendency to restrict its activity? Is the thrust of governmental interest in the informal sector framed by policy, economic, or regulatory concerns? Indeed, should a government respond to this population, and if it does, should its role be to design strategies, to formulate policies, or to provide direct assistance? Should it engage in all three?

For those who have worked with this population in the past (primarily the small, private, development organizations<sup>1</sup>), additional questions emerge. What level of knowledge exists among policy-makers and government officials regarding the successes and failures of assisting this sector? How do the non-governmental organizations with experience in this area view increased government interest, and to what degree are they versed in the policies evolving in their own countries regarding the informal sector?

The search for answers to these questions gave rise to a five-day international conference in Quito, Ecuador conducted in November, 1989. The conference was convened by ACCION International (ACCION/AITEC), a U.S. based, private development organization that provides technical assistance in microenterprise development, and the Institute of Socioeconomic and Technological Research (**INSOTEC: Instituto de Investigaciones Socio-económicas y Tecnológicas**), a private research institution in Ecuador. The United Nations Development Programme (UNDP), the Inter-American Foundation (IAF), Private Agencies Collaborating Together (PACT) and the U.S. Agency for International Development (AID) financed the conference proceedings.

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1. Throughout this publication, organizations not affiliated with government initiatives will be referred to as private development organizations or non-governmental organizations (NGOs).

This event gathered representatives from government entities, donor agencies, and local private development organizations. Along with the microentrepreneurs, these three groups constitute the major players in the informal sector. The conference gathered 65 participants from 13 Latin American and Caribbean countries, the United States, and Canada who represented the following organizations: 37 local private development organizations (28 of which are affiliated with ACCION/AITEC); seven government representatives from six countries (Ecuador, Guatemala, Mexico, Paraguay, Peru, and Colombia); eight donor representatives from four multilateral and bilateral institutions and foundations (The World Bank, the Inter-American Development Bank, The Inter-American Foundation, and the Calmeadow Foundation), and representatives from three U.S. private development organizations (Catholic Relief Services, CARE, and ACCION/AITEC).

The underlying premise of the conference stated that the informal sector of Latin America represents a challenge and an opportunity of such magnitude that neither the public sector, nor the private sector alone, can respond adequately. The conference discussions focused on whether public and private sector organizations can or should collaborate in reaching the informal sector, and how to initiate or improve this intersectoral relationship.

The objectives of the conference were:

- to provide a forum for a dialogue among public and private sector professionals in the field of microenterprise development;
- to exchange information about informal sector policies and activities by governments and private sector institutions and to analyze the strengths and weaknesses of their involvement in the informal sector. Inputs to this objective included six country-level research documents prepared for the conference, which comprise the second part of this publication. Government representatives from Mexico, Guatemala, Colombia, Ecuador, Peru, and Paraguay also made presentations at the conference; and
- to formulate strategies and recommendations for improving, strengthening, and consolidating effective public/private

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sector collaboration in the field of microenterprise promotion.

The conference was organized into four sessions. The first session included presentations by government representatives, NGOs, and donor organizations to inform the participants about existing policies, programs, and strategies. The second session was comprised of working groups that mixed private and public sector representatives from different countries to compare, discuss, and extract the key elements from the presentations. These working groups focused on the philosophy and objectives; methodology and sustainability of programs; management of human resources and information; and mechanisms for financial intermediation. Their work led to a summary of the strengths and weaknesses of the various approaches that were presented.

The third session was dedicated to country working groups in which representatives from each country carried out a policy development exercise that enabled them to design a country by country strategy for improving government/NGO/multilateral policies related to the informal sector. In the last session of the conference, participants reviewed the country level plans and summarized their major commonalities.

This overview has two goals: to summarize the factors that contributed to the need for this conference, and to report on its proceedings. The first part identifies five causes behind increased government interest in the informal sector during the last five to ten years. It also considers the role of private development organizations in microenterprise development and the reasons for their continued interest to expand their activity. Finally, it presents the reasons behind increased donor attention on the informal sector and its relationship to policy and program formulation.

The second section presents the findings of the conference. It summarizes and analyzes the various governmental approaches towards the informal sector. The discussion focuses on how governments allocate resources and implement programs rather than on their overall economic or policy formulation process. It also suggests several factors that will enable private development organizations to enter into a dialogue with governments, especially in the area of extending services to the informal sector. Finally, the discussion

summarizes the various strategies for public and private sector collaboration and interaction that have emerged as well as a consensus of recommendations from the participants on future government, private, and donor assistance to microenterprise work in the informal sector.

## **GOVERNMENT INTEREST IN THE INFORMAL SECTOR**

### **The Government Perspective**

In the last five years, every government in Latin America and the Caribbean has increased its attention on the informal sector. The universality of the sector, its heterogeneity and its growing population have turned the state, municipal, and local authorities in its direction. While issues related to tax evasion and circumvention of the law by the economic activities in this sector find their place in this increased interest, in every instance, the government's position is to support the sector's development rather than to obstruct its economic activity. The reasons behind this attention on the informal sector must be examined in light of the events and development in this region during the last decade<sup>2</sup>.

### **Economic Considerations**

For Latin America, the decade of the 1980s has been characterized by economic crisis and regression. Per capita production has consistently fallen. In many countries, it is lower today than it was a decade ago. Fixed investment in productive capital fell by over 30% between 1980 and 1985. Practices associated with the 1970s such as high commodity prices, cheap external financing, increased public investment, and social welfare programs have yielded to reduced international flows, lower commodity prices, high real interest rates, and the overwhelming debt burden in the 1980s. The decade has brought a development setback for the region, and hundreds of millions of people have experienced an economic decline in their standard of living<sup>2</sup>. Poverty has increased in every country.

Given this landscape, governments are engaging in structural adjustment reforms for their economies and simultaneously

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2. World Bank. **World Development Report 1989**. Oxford University Press, 1989.

searching for ways to foster growth. Foreign borrowing to finance development is no longer an option due to high interest rates and the enormous current foreign debt. The assertion that growth would come through the impetus of large, modern, transnational economies has not yielded results and subsequently, Latin American governments have begun to look internally for ways to produce and create economic growth. They identify the informal sector as one whose productive potential must be considered in the country's overall development plan, but not as the answer to the difficult situation each country faces.

### **Size of the Population**

Demographic patterns constitute a second reason behind government interest in the informal sector. Thirteen of twenty Latin American countries registered lower annual population interests growth in the 1980s as compared to the 1960s and 1970s. However, these rates remain high and project increases, for example, of 23 million and 37 million for Mexico and Brazil respectively by the year 2000<sup>3</sup>. However, it is the age composition of the population and its concentration in large urban centers that troubles governments. In most countries, over 50% of the population currently resides in cities, and is comprised primarily of semi-or unskilled young people.

Not surprisingly, the informal sector in each economy has grown at a faster rate, absorbing many of these new entrants into its labor force. From a government's perspective, the informal sector provides an alternative for jobs and responds to its need to create employment opportunities for its growing population. Job creation in this sector requires low investment levels, reflects the skill level of the majority of the labor force, and encourages the production of goods and services that supply the poor populations.

### **The Return of Democracy**

In the last two years, about a dozen countries in Latin America and the Caribbean have conducted peaceful presidential elections. While elections alone do not mark the arrival of a democratic system, the return to establishing

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3. *ibid.*

democratic structures has swept the region in the last several years. This important change has brought with it an increased government emphasis on formulating development strategies that include the poorer sectors of society. Democratic principles have also reestablished the electoral system in these countries, suggesting that political parties will vie for votes, and that groups will pressure governments to respond to their interests.

There is a growing sense within the region that informal economies will continue to grow. It is therefore essential that this population participate and be integrated into the democratic structure of each country. Significant writings in recent years, especially de Soto's *The Other Path*, have raised complex issues regarding the policies, legality, and regulatory environment that must be considered by national governments in relation to the informal sector. The formation of organizations and associations by the **informales** to represent their interests also may be a significant component of the democratic processes emerging in these countries. Indeed, because of the informal sector's size and its capacity to exert pressure, it will continue to constitute a population that democratic governments cannot ignore.

### **Conceptual Basis for Understanding the Informal the Sector**

Perhaps more so than in other developing regions of the world, the rise of the informal sector in Latin America has generated a rich body of literature that seeks to explain the sector's emergence and its position within the social and economic structure of each country. The analyses focus not only on the reasons why the sector exists and persists, but also on its capacity to generate growth and employment, and on the constraints and conditions under which it operates. Within the diversity of research at both the macro and micro levels, four major interpretations of the informal sector emerge and are summarized briefly below<sup>4</sup>.

One approach, developed by the International Labor Organization (ILO) and the Regional Employment Program in Latin America and the Caribbean (PREALC), bases its analysis on two notions: the identification of the informal sector as the

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4. Cartaya, Vanessa. "El Confuso Mundo del Sector Informal" *Nueva Sociedad*. Julio-Agosto, 1987, pp. 76-88.



excess supply of labor not absorbed by the modern productive system, and the scarce availability of capital for production<sup>5</sup>. This approach emphasizes the process of modernization, the demographic explosion, and the high rate of urbanization as factors that contribute to the growth of the informal sector. It studies labor force issues such as its size, permanence as excess supply, evolution, and salary profile. The relationship between the modern and the informal sector also enters this analysis, which identifies the complex linkages and levels of dependency between the formal and the informal sectors.

A second approach emphasizes the productive viability of the informal sector identifying it as the means to lower production costs by keeping salaries low and avoiding worker's benefits. It highlights the relationship between the formal and informal sector as one of subordination, in which the informal sector maintains low salaries and production costs within a capitalist system of production<sup>6</sup>. Some view the role of the informal sector as one of subsidization of part of the cost of the formal enterprises, that which enables them to reinforce low wages. The inability of the smallest firms to accumulate surplus capital also enters this analysis as part of the relationship between formal and informal sectors.

Both the first and second approaches are versions of the so-called "structuralist" school of thought which underlines the growing disparity between the formal and informal economies within countries and argues for the need to equalize the differences<sup>7</sup>.

A third approach draws from the evolution of labor markets in developed countries to emphasize the type of production undertaken by the informal sector. Smaller productive units

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5. Mezzera, Jaime. "Excess Labor Supply and the Urban Informal Sector: An Analytical Framework". in Marguerite Berger and Mayra Buvinic, eds. **Women's Ventures**. Kumarian Press, 1989.

Tokman, Victor E. "El Imperativo de Actuar". **Nueva Sociedad**. Julio-Agosto, 1987, pp 93-105.

6. Moser, Caroline. 1983. "The Informal Sector Reworked: Viability and Vulnerability in Urban Development". Paper presented at United Nations Centre for Regional Development Seminar on the Role of the Informal Sector in Urban Development, West Berlin.

7. Annis, Sheldon and Jeffrey Franks. "The Idea, Ideology, and Economics of the Informal Sector". **Grassroots Development**. Vol. 13, No. 1, 1989 pp. 9-22.

represent a new form of organization that may lower production costs, especially in labor, and may respond more appropriately to the economic crisis in most developing countries. This approach is less well received in Latin America than the preceding analyses, but has been used as the basis for important findings about production in the informal sector and its contribution to the economy<sup>8</sup>.

A fourth interpretation of the informal sector identifies it as a key manifestation of the entrepreneurial spirit in the region, one that absorbs a significant percentage of the labor force. However, the productive potential of the sector is sabotaged by the excessive regulations that exist in every country, which force production to occur in an extra-legal manner<sup>9</sup>. Promoted by the Institute for Liberty and Democracy, this interpretation emphasizes the burden that governments place on this sector and the role that deregulation and improved laws would play in strengthening its production.

These summaries of the debate over the informal sector do not reflect the breadth and depth of each analysis, but highlight the differences that persist between interpretations. They also demonstrate that these interpretations have advanced the theoretical analysis of the informal sector but have provided very little direction in the methods and approaches needed to reach this sector. While they call for government action, policy formulation and allocation of resources to the sector, specific guidance or strategies are not formulated. Hence, the governments that are currently designing informal sector strategies can draw from these schools of thought to buttress their position regarding the informal sector, but must look elsewhere for methodologies or approaches for reaching it with services. The experience of private development organizations that have extended services, particularly credit, for the last fifteen years, provides important learning ground for new program strategies.

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8. Liedholm, Car and Donald C. Mead. 1987. "Small Scale Industries in Developing Countries: Empirical Evidence and Policy Implications". MSU International Development Paper No.9, East Lansing, MI: Michigan State University.

9. de Soto, Hernando. **The Other Path**.

### **Increased Donor Interest**

The growing resources from multilateral and bilateral donor organizations for extending services to informal sector producers is the final factor that contributes to government interest in this sector. Most U.S. and European donor organizations have developed a keen interest in financing research or action programs in this field. The United States Agency for International Development (USAID) operates under a Congressional earmark of \$75 million in microenterprise lending for fiscal year 1990. The Inter-American Development Bank (IDB) has initiated its own microenterprise program that could assign nearly \$500 million in loans for this area in the next five years. The World Bank has also started its own exploration, paying particular attention to the integration of this sector into their broader industrial sector loans. Likewise, most smaller foundations, such as the Inter-American Foundation, the Ford Foundation, and others have also assisted non-government institutions to initiate pilot programs and later to expand their outreach.

Donors and governments have also collaborated in developing program strategies. In some cases, such as Colombia and Mexico, governments have worked in close concert with the Inter-American Development Bank to develop strategies that are then financed by the IDB.

### **The Perspective of Private Development Organizations**

Private development organizations in Latin America have provided assistance, training, credit, and other services to the poor who comprise the informal sector for the last fifteen years. As one example, ACCION maintains a formal affiliation with 37 such organizations which operate in 12 countries in Latin America and the Caribbean. These organizations extend credit and training in over 65 cities to very small producers and retailers. Due to the scope of their activities and their level of experience, their impact is significant. Each month, these organizations disburse over \$2 million in loans, half of which are extended to solidarity groups of three to five members. The average loan per person is about \$200. The remaining funds are disbursed to individual microentrepreneurs with loans averaging about \$520 per person. These programs reach tens of thousands of microentrepreneurs per month and will continue to expand their activities.

While ACCION-affiliated institutions probably represent the bulk of the activity that private development organizations undertake with the informal sector in Latin America and the Caribbean, there are also various other institutions with substantial portfolios and years of experience working in microenterprise development. The National Development Foundations in many countries and the Carvajal Foundation (*Fundación Carvajal*) in Colombia are two noted examples.

The approaches and strategies vary among these institutions, some more successful than others. The organizations which contribute significantly to improving assistance to the informal sector base their work on the following three factors.

### **Reaching the Poor**

To reach the poorer sectors of society and assist them in their development was the primary objective behind the formation of most private development organizations during the 1960s and early 1970s. During that time, they focused their work on rural areas and developed projects with poor communities which were ignored by broader government programs or projects designed by large donors. These organizations selected specific communities, provided them with training, promoted their internal organization, and delivered resources and services to them. A social development focus characterized the nature of most of this work which often used an integrated rural development approach, and always relied on outside donor funding.

In the late 1970s and 1980s, as poor populations flocked to the urban centers, NGOs emerged in cities as well and began to address the problems of the urban poor. Their work revolved primarily around the creation of services and infrastructure lacking in poor communities - housing improvement, day care, water, health care and organizing neighborhoods around these issues. Support for vocational training and income generation programs followed.

The emphasis on providing financial resources - capital - to the poorest producers evolved at this time, as it became clear that credit, unattainable by the urban poor through the banking sector, prevented the poor from investing in local income-generating activities. Private development organizations increased their knowledge through their direct association with

poor communities and after decades of experience in working with the poor in relief and service activities, began to support local productive and commercial activities as well. A number of specialized institutions have evolved with credit and training programs of considerable magnitude geared to the poor in the informal sector. Today, these specialized organizations have developed state-of-the-art credit programs and provide the lead in developing methodologies and policies for access to credit in the informal sector.

### **Development of a Methodology**

In the process of extending credit and training to the informal sector, private organizations have developed valuable technologies and strategies for reaching this population. Because of their organizational characteristics, these institutions were well positioned to test innovative strategies and approaches for effectively extending credit to microentrepreneurs<sup>10</sup>. In the case of ACCION-affiliated programs, their experience has yielded a methodology for program implementation that serves as the basis for each country program. The characteristics of this approach to extending credit are straightforward - the importance of group lending, the use of commercial interest rates, systems for agile loan review and disbursement, incentives for repayment, flexibility and responsiveness to the borrowers' needs - are the result of many years of tests, experimentation, and design by these organizations. The broad application of this solidarity group approach means that programs can deliver credit to more micro-businesses, at a lower cost, while incorporating the poorest individuals, including a large percentage of women.

Today many new programs that extend credit to microentrepreneurs rely on this methodology to design their own. Furthermore, older programs that have evolved successfully are currently experimenting with additions and revisions to improve this methodology, its reach and potential. In Guatemala, for example, two programs are experimenting with the role of the solidarity group, expanding it from being the recipient and manager of a loan, to one that conducts the loan

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10. Mckee, Katharine. "Microlevel Strategies for Supporting Livelihoods, Employment, and Income Generation of Poor Women in the Third World: The Challenge of Significance". *World Development*. Vol. 17, July 1989 pp. 993-1006.

review procedure and assumes other tasks previously held by the staff.

Extending credit to hundreds and thousands of borrowers in an efficient and effective way requires a complex mix of institutional capacity, monitoring structures, information systems, trained staff, promotional activity, and resources. Private development organizations believe that the methodology they have developed is an effective system for reaching the poor and constitutes one of their most important contributions to meeting the needs of the informal sector.

### **Creation of Self-Sufficient Programs**

Creation of self-sufficient credit programs represents an additional contribution to the informal sector by private development organizations. For example, ACCION-affiliated programs define self-sufficiency as a program's capacity to generate enough revenue from its credit activity to cover all its operational costs as well as the costs of money if the program borrows to on-lend. Programs develop the capacity to achieve self-sufficiency once their portfolios reach the size needed to break even. Once they are self-sufficient, these programs need additional outside infusions of money only when they decide to expand considerably or when inflation levels become too high and generate negative interest rates, and other factors that preclude self-sufficiency.

The concept of conducting self-sufficient development programs that reach the poor is revolutionary. While most microenterprise assistance programs are not yet self-sufficient, some in the ACCION network are, and all cover a substantial part of their costs of operation. Their reliance on outside donors which has been the cornerstone of development efforts, changes considerably, since these programs can now combine grants, their own revenue, and loans to conduct their programs.

A growing number of private development organizations are internalizing self-sufficiency in their development methodology which is framed by the emphasis on long-term sustainability. They have accessed other sources of money for developing their programs including revenue from program activities, and loans from the commercial sector to lend to microentrepreneurs. Self-sufficiency becomes an important way to leverage additional resources for development and assures that programs will not

buckle under changes in donor funding patterns. From the perspective of private development organizations, self-sufficiency becomes a key component of any successful program.

## **GOVERNMENT RESPONSE TO THE INFORMAL SECTOR**

### **The Assumptions Behind Government Action**

The importance that the informal sector has acquired in each country determines to a great degree the role that the government plays. The desirability or the wisdom of formulating a spectrum of policies geared to the informal sector emanate from the assumptions about this sector held within the government and in the country in general. In some cases, national debate regarding the informal sector stands center-stage. Annis and Franks note that in Peru the issue is integral to political debate, and they suggest it may influence the upcoming presidential elections.<sup>11</sup> In most cases, however, informal sector issues and their relationship to government policy do not enjoy such high visibility and receive less attention.

Discussions at the Quito conference suggested that governments vary considerably in the way that they perceive the informal sector and their relation to it. Before presenting government strategies currently underway, it is instructive to visualize these government initiatives in the context of the basic premises that the state holds towards the *informales*. Participants in the conference identified four ways in which governments currently frame their role towards the informal sector, which contributes to the policy and programs that are enacted.

### **The Detached Role**

This government response is based on a lack of interest in the sector and a tendency to exclude it from planning or policy-making considerations. In the early 1970s, when the informal sector was beginning its dramatic growth, many governments in Latin America fit into this category. They maintained either an indifferent or unresponsive position based on lack of

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11. Annis and Franks, 1989.

information or on the assertion that this sector was of little economic or social consequence. Based on the assumption that large industry is the engine of growth in a country, micro level production was not considered as a significant factor in the economy. However, the growth of the sector, and other factors suggested earlier in this discussion have turned most governments from detached observers into actors, and placed them in one of the other three persuasions that are described below.

### **Passive Collaboration**

In this setting, a government recognizes the existence of very small producers who operate informally, and while retaining an ambivalent position regarding its own role, it provides space for local organizations and international donors to provide resources and services to this population. There is sporadic interaction between government entities and implementing organizations. The latter tend to conduct small programs and prefer to work in an independent manner.

As a passive collaborator, the government does not initiate a process of building its own strategy or program. In spite of research on this topic suggesting its importance, the role of the informal sector in the economy does not form part of the debate among policy makers. While there may be an initial call to consider the issue at the national level, there is no consensus regarding its relative importance.

During the late 1970s, and in some cases in the 1980s, most prevailing environments regarding the informal sector fit into this category. With the exception of one or two countries, most notably Colombia, most governments considered the informal sector outside the venue of policy makers.

### **Active Collaboration**

Under this category a government begins the process of integrating responses to the informal sector into its national agenda. It assumes the role of defining a policy and engages in debate among policy makers, academics, practitioners, and donors regarding the relationship between macro policy and micro production. The state also studies the diverse ways it can respond to the informal sector, including defining policy and allocating resources.



In this process, a government can look to non-governmental institutions as a means to channel credit and training to microproducers, and can choose to build on their current experience. Active collaboration in this sense involves the establishment of a favorable climate to enable these institutions to continue and expand their work with support but no interference from government entities. This can include national recognition of the microenterprise sector, support for fora to discuss the issue, funding research and scaling up pilot programs. In other cases, it may mean that the state also provides funds for the scaling up of these programs, and becomes an important resource for the NGOs that reach the informal sector.

### **Directive Collaboration**

In this final category, the government also defines a policy towards the informal sector. Unlike the category above, however, in this case it determines not only policy but also programs. The role of the government becomes that of a policy maker as well as that of the main implementor of programs to extend services to the population.

The role of NGOs in this setting becomes more closely controlled by the government. The government involves itself in designing methodologies and implementing programs. Once it combines these functions with assignation of funds for their initiation, the government creates a parallel source of services that operates independently or in competition with existing NGO programs. In some cases, the government seeks to integrate the work of existing NGOs into its program, and to regulate and administer it.

### **Government Approaches: Two Major Tendencies**

While most Latin American governments fall into the general categories described above, the movement among them is in the direction of being active or directive collaborators in informal sector activities. Policy formulation, program design, and in some cases program implementation, constitute the main areas of government activity. Of particular interest in this document is to focus on the government's role in extending resources, especially credit, to the informal sector and to examine its characteristics. Since the focus of the discussion concentrates on microenterprise development programs, policy

formulation and regulatory considerations are not discussed at great length.

The level of government involvement and experience in enacting policy and designing programs directed to the informal sector varies considerably. The approaches of the countries presented at the conference, Mexico, Guatemala, Costa Rica, Dominican Republic, Colombia, Ecuador, Peru, Bolivia, Brazil, Chile, and Paraguay can be divided into two major tendencies. The first one includes governments that have started to address the issue of the informal economy in recent years and find themselves in the early stages of formulating a strategy and a policy framework. Brazil, Bolivia, Dominican Republic, Paraguay and Costa Rica fall into this category, though they are in different places within the continuum described below.

### **Early Stages of Government Response**

Governments in this category are currently in the process of designing a response to the informal sector. They have not established a clear national strategy and have not allocated resources. The issue of the *informales* receives a varying degree of urgency and in the case of newly-installed governments, it has not yet been fully determined. There is some level of government activity in formulating policy and programs in all the countries mentioned.

This early stage exhibits additional characteristics. First, in comparison with the more advanced countries discussed below, there is less information on the informal sector available. Country-level baseline data, national or regional research, and conceptual frameworks exist but have received less attention and are not as detailed. Fewer people appear involved in analyzing the sector and in promoting approaches to address it. Second, there has generally been less interest in this sector on the part of national or regional governments and consequently, there is no national strategy to address it. This factor may be partially responsible for the relatively limited data base in these countries, but may also result from the overall lesser influence that private institutions have had in advocating for a government response.

A third characteristic of this category is that most efforts to extend services have resided in the hands of small organizations that operate in a relatively autonomous manner. In some cases,

these private programs have been successful at reaching the sector but have remained small and isolated. In others, where their results are noteworthy, these programs have contributed to raising the government's interest. The Foundation for the Promotion and Development of the Microenterprise (PRODEM) in Bolivia presents an interesting example of the success of a private initiative in this regard. In its first three and a half years of operation (1986- 1989), this program has reached over 7,000 microentrepreneurs with over \$5 million in loans that average about \$225 each, and maintained a repayment rate of over 99.5%. Its methodology and approach, as it now begins to open new regional offices and establish national coverage, have been studied closely by the government in pursuit of a national strategy.

Finally, the ingredient of coordination among efforts geared to the informal sector has been missing or is only now being developed in these countries. The governments have not assumed this role, and most private organizations have tended to operate on their own. One exception in the Dominican Republic is the Association for the Development of Microenterprises (ADEMI), which has provided more than 20,000 loans to microentrepreneurs in the last six years, has operated at a national level, and has also assumed the role of disseminating information on the sector and of coordinating its efforts with research and other institutions. To some degree this organization has started this process which may later be assumed by the government.

All governments included in this tendency currently are involved in exploring the issue of the informal sector. The majority straddle a line between remaining detached and becoming passive collaborators in responding to the informal sector. It would appear that their responses will be to support this sector through a concerted effort, and that they may move to be incorporated into the second broad category of government response to the informal sector, which exhibits a more developed and carefully designed approach.

### **More Advanced Government Responses**

Governments that exhibit a more advanced understanding of the informal sector and express greater consensus about the need to develop a solution comprise the second category among countries represented in the conference. Countries such as

Colombia and Mexico have pioneered governmental responses and are perhaps the most advanced because they have established national level strategies. Peru has a program of direct services, which Guatemala also initiated in the last two years. Ecuador is in the process of establishing the structure for a similar program, while Paraguay has still not reached this point.

These governments appear to have a positive assessment of the contribution that microenterprise development can bring to households and communities, and have progressed to different degrees in formulating their response. Their approach supports Portes' assertion that the official attitude has been one of active support of microentrepreneurial ventures through programs and policies<sup>12</sup>. The six countries included here, Guatemala, Colombia, Mexico, Peru, Ecuador, and Paraguay locate themselves at different points within a continuum.

Governments have carved their own paths based on the specific circumstances of the informal sector in each country, and by the degree of attention that the issue has received. In comparing the way governments in this category are addressing the informal sector, one can identify several characteristics which seem to contribute to the evolution of an effective government program. These observations emerged from the consensus of conference participants and are instructive for governments that are at an early stage of policy and program formulation.

### Integration into a National Plan

Effective approaches to addressing the informal sector have incorporated the design of this strategy into the process of designing the national development plan. As such, the issue has been studied from a national perspective, and has not been relegated to the regional or ministerial level as a sub-task. The countries that display greater coherence in approaching the informal sector have addressed the issue at the macro level, and considered issues such as its role in the economy, its job-creation potential, and its relationship to larger productive

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12. Portes, Alejandro. **The Informal Economy: Studies in Advanced and Less Developed Country**. Johns Hopkins University, 1989.

units. The implementation of the programs has been placed in the hands of ministries or regional or local governments.

Colombia presents a good example. Its "National Plan" of microenterprise development provides a broad vision of the problems and needs of the sector. It transcends the regional focus that plagues many of Colombia's programs. Working at the national level, the "Plan" has become a coordinating instrument that seeks consensus in approach among the various players, and considers extending services at a national level.

This national-level response has also enabled the Colombian government to consider a variety of factors that relate to the informal sector. Issues related to marketing, technology, and production characteristics are among subjects that the government identifies as key and integrates into its plan. Results obtained through research also enter into the picture. Colombia is valued for the high degree and quality of data, analysis, and research conducted on this sector, which the government uses in its program and policy formulation. Finally, the government has looked to private institutions and analyzed their models for extending services as it attempts to develop a national strategy. In this context, the solidarity group methodology becomes an interesting approach to extending services to microenterprises. Over 15 private institutions grouped under the Association for Solidarity Groups currently use this method in the country, and disburse almost \$1 million per month in loans of less than \$300 in nearly one dozen cities. Through its members, this umbrella organization has reached over 16,000 microentrepreneurs and is in the process of expanding its outreach.

### Role of Coordination

Governments that address the informal sector in an effective manner have defined the important difference between acting as a program implementor and performing the role of a coordinator of activities related to the informal sector. As coordinator, a government can create space for increased response from diverse sources. It recognizes the various players that enter into microenterprise development and the roles each of them plays and seeks to facilitate their interaction and individual work.

For example, commercial institutions provide the financial system into which microenterprise development ultimately must be incorporated. Private development organizations perform the role of implementors, operating more directly with the microentrepreneurs than any other institution. Donor agencies seek to place resources into the informal sector and at the same time propose policy and regulatory changes. An effective government approach creates a favorable environment for these activities and collaborates in this evolution by facilitating dialogue, gathering information, and assessing policy changes.

The vision suggested for the government's program in Paraguay is based on the concept of involving as many players as possible and assigning the task of coordination to the government. In this way, it can encourage use of banks to provide credit funds, local institutions to implement the programs, outside entities to provide technical assistance, donors to assist in covering operational costs, and other entities to conduct research and training. While this description belies the complexity of coordinating these actors effectively, it nevertheless highlights the importance of the diverse needs that characterize the informal sector which can only be met through a coordinated effort among institutions with diverse expertise and resources.

### Program Implementation

Since not all governments choose to implement programs directly as part of their strategy, one finds two tendencies in this area. In some instances, a government recognizes the presence of NGOs that have this expertise and relies on them to continue extending services to the sector. It may make resources available to them by channeling funds to their programs, such as those provided by the Inter-American Development Bank or other donors. In Colombia, for example, the government lends funds to implementing organizations, and coordinates the technical cooperation from international organizations. While government organizations do not conduct credit programs, the largest and best known training center in the country, the National Learning Service (*SENA: Servicio Nacional de Aprendizaje*), is government based, and complements and supports the work of the NGOs. The Dominican Republic, while still at the early stage of policy and program formulation, also makes loans available to ADEMI, an NGO that conducts the largest microenterprise program in the country.

Under the tendency depicted here, implementing organizations retain autonomy over their programs, utilize their tested methodologies, and choose the population and region for their work. From the perspective of NGOs with experience in reaching the informal sector, their incorporation as recognized program implementors is an essential component in effective government strategies. In many cases, as the ACCION/AITEC affiliates and other examples demonstrate, there are NGOs that have earned this recognition and can contribute in a significant manner to a government's national plan.

A second tendency apparent in some countries features the government as the direct implementor of services to the informal sector. Guatemala presents a good example through its three-year old Sistema Multiplicador de Microempresa Urbana (SIMME) program. The implementation of this microenterprise development program became the centerpiece of the government's response to the sector. Conducted out of the office of the vice president, this program mounted a massive response by extending credit and technical assistance to microentrepreneurs. While SIMME selected various NGOs to carry out the implementation function, the management, methodology, and identification of the program remained government based. At a national level, SIMME became identified as the government's centerpiece vis-a-vis the informal sector, and hence the success of this strategy was measured more in terms of clients reached or credit disbursed than in terms of policy or legal reform enacted.

### **THE STRENGTHS AND WEAKNESSES OF GOVERNMENT AND PRIVATE INSTITUTIONS IN MICROENTERPRISE DEVELOPMENT PROGRAMS**

The table below summarizes the general advantages and disadvantages that governments and private institutions bring to the implementation of microenterprise programs. It enables us to identify the areas in which the public and private sectors can contribute in a significant way to forging an effective national plan to address microenterprise development. Also, it compares the factors that limit the outreach of both types of entities, and that become problems when program implementation begins. Of course not all these observations apply to every government and private sector entity, but they provide the basis for comparing the relative merits and shortcomings of each.

The government's strengths emerge from its capacity to define a broad mandate in this area that can create the environment necessary for reaching the informal sector. This mandate consists of a variety of factors, including the widespread dissemination of information; de call for political support at the national and regional levels; the identification of financial resources and their allocation to this sector; and, the review of policy and regulatory concerns that affect microenterprise activity. Additionally, the government can call upon its own entities as well as private institutions to garner the technical and human resources necessary for a national level program.

**TABLE 1**

**ADVANTAGES AND DISADVANTAGES  
OF GOVERNMENT AND PRIVATE INSTITUTIONS  
IN MICROENTERPRISE DEVELOPMENT**

**GOVERNMENT**

<b>ADVANTAGES</b>	<b>DISADVANTAGES</b>
Widespread dissemination and political support	Excessive bureaucracy; Corruption; Politicization of programs
Capacity to obtain significant level of funds	Little or no experience to implement microenterprise programs
Places microenterprise development in context of broader macroeconomic considerations	Can allow programs to grow too large without necessary institutional base
Can address broader policy and regulatory concerns	No incentives to make programs work
Can mobilize institutional and human resources in public/private sector	Possible lack of consultation with NGOs, grass-roots
	No mechanism for long-term sustainability
	Perceived as social welfare and not economic development



## PRIVATE INSTITUTIONS

ADVANTAGES	DISADVANTAGES
Strong methodology based on experience	Limited institutional capacity for scaling up programs
Committed, trained staff	Low level of technical expertise especially in financial and information systems
Capacity to reach to grass-roots associations	Often lack sufficient resources to expand programs
Little or no corruption	Operate in isolated manner
Responsive and non-bureaucratic	Little interaction or knowledge about government activity in informal sector
Motivated to scale up programs	Limited vision that maintains programs small
Striving for self-sufficiency	
Capacity to associate among many to form a coordinated effort	

Private institutions also bring important advantages, some of which have been discussed above. Their strong methodologies are based on lessons learned in nearly two decades of experience. The programs that they currently implement exhibit important characteristics of successful efforts: they are agile in their operations, feature committed staff, seldom suffer from corruption, often are structured to scale up, and consider self-sufficiency the key to long-term sustainability. These private institutions reach the grass-roots communities and organizations in an effective, generally unpoliticized manner, and can facilitate their inclusion in designing and planning programs.

The limitations of both government and private institutions are also key in examining an approach to the informal sector. Some of these limitations are inherent to the nature of the institutions. Governments, for example, suffer from corruption and even under optimal circumstances, tend to establish

excessively bureaucratic systems. Both factors would decimate a microenterprise program in a short period. Private development institutions, on the other hand, tend to be small and on an individual basis contribute little to addressing the issue.

There are additional limitations to consider. On the side of the government, the general lack of experience in implementing programs can lead to serious design and methodological flaws. Programs can grow too large without the necessary institutional bases, and crucial issues such as determining the interest rate and creating mechanisms for long-term sustainability can be ignored. Governments also can choose to exclude experienced private organizations and grass-roots associations in the planning stages. Finally, governments run the real risk of developing social welfare programs that are not perceived as an economic development response to assist a productive sector in the economy.

Private development institutions also face important disadvantages. In many cases, private institutions have limited structural and technical capacity and cannot expand their activities in a significant manner. They also have limited resources which in some cases determine the pace of growth of their programs. Finally, deficiencies in technical areas, especially in financial management and information systems, continue to handicap their programs.

At the same time, private institutions lack the vision to organize with other private organizations and create a larger, coordinated effort. The tendency to operate in an isolated manner and to maintain little interaction with the government creates a fragmented and less effective alternative for creating programs that reach large numbers within the informal sector.

Clearly, the nature and scope of these different institutions enables them to bring varied strengths to the process of planning and implementing a program for microenterprise development. The limitations that most public and private sector organizations face can be identified either as inherent to their institutional character, or as shortcomings that can be addressed. However, if private and public institutions ignore the limits intrinsic to their individual reach, they will not be able to build programs shaped around the strengths that both types of institutions bring to microenterprise development.

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## CONCLUSIONS AND RECOMMENDATIONS

The conclusions that emerged from this conference provide useful insight into the direction governments should follow regarding the informal sector. These appear here as recommendations that will help strengthen public and private sector efforts at the service of the informal sector. They highlight areas of inquiry that governments must address as they seek to reach, regulate, and integrate the informal sector.

1. ***The growth and development of microenterprises should be an indispensable ingredient of a country's national economic plan.*** Those governments that are responding in an effective way are addressing the informal sector as part of their macroeconomic development objectives. The policy and strategy towards this sector is not formulated in an isolated way but comprises part of the country's total strategy for development.
2. ***Programs that reach the informal sector, whether conducted by private entities or by the government, will require a favorable environment in which to operate.*** As these programs grow to the national level and encompass a significant number of microenterprises, their ability to continue to expand effectively will be determined partly by the legal and policy framework that evolves in the country. Governments that have advanced in this area are more likely to provide positive support for the extension of financial services to this sector through private and public financial institutions, NGOs, and by constructing a legal framework for the informal sector.
3. ***Experience demonstrates that a government's approach to the informal sector must be integrated to include policy formulation, legal and regulatory modifications, and service extension in credit, training, and other needs to this population.*** A comprehensive policy that addresses the informal sector cannot be based on an emphasis in any one line of action, but must integrate all. This conclusion is particularly relevant for those governments in the early stages of formulating a policy and strategy related to this sector.
4. ***The most useful role for the government as it develops an approach to the informal sector is to function as an active***

**collaborator that integrates other institutions into a national strategy.** As such, the government assumes the role of formulating policy and affecting the regulatory environment, and provides support - both moral and financial - to experienced NGOs in the extension of services to microentrepreneurs. There are three key reasons for dissuading governments from assuming the lead in designing methodologies or implementing credit and training programs for microentrepreneurs:

- **Government programs can too easily become politicized.** Extending small loans to a large, needy population that constitutes a significant portion of the electoral vote may appear to garner attractive political dividends for a government in power. The benefits, however, would only be short-term. From the perspective of the borrower, loans from the government are often considered "handouts" which lead to poor repayment and a quick decapitalization of the credit funds.

For a government office, the dangers of compromising the integrity of a microenterprise development program can be enormous as other priorities enter into decisions regarding program implementation. Pressure to favor borrowers with the same political affiliation as the government would ensue, as would allegations of misuse. Bureaucratic considerations would also deplete the vigor behind the agile methodology that characterizes successful programs. The expertise gained through years of experimenting with these programs would yield little benefit for a government - managed initiative.

In short, co-optation of a government - implemented microenterprise program is likely to occur because the political payoffs are high. While making loans may appear to be the quickest and least difficult task a government can undertake, and at the same time may be politically attractive, it is rife with land mines that could lead to a program's demise.

- **It is important that the government play a coordinating role among the many actors involved.** Because there are many players involved in addressing issues related to

microenterprise development and the informal sector in general, the role that the government can play as a main coordinating body becomes crucial. The interaction among policy makers, researchers, financial institutions, program implementing organizations, donors, and other entities is an essential factor in the creation of a coherent, multi-dimensional strategy. Once the government assumes the direct role of implementation it sacrifices the leverage and access necessary to play the broader coordinating role.

- ***The government should review the regulatory and legal framework surrounding the informal sector.*** In the same vein, the government must maintain the capacity to consider broader issues that influence microenterprise development, particularly those related to legal and regulatory concerns. As suggested above, these factors influence every aspect of microenterprise production and marketing, and touch on areas such as price controls, trade regulations, allocation of finance capital, and others. The complexity behind the web of regulations and legal directives has kept governments from addressing this issue with coherence. The presence of a government-administered microenterprise program would sidetrack the state from conducting these much more complex but necessary tasks.
5. ***Non-governmental organizations have developed the expertise to operate as financial intermediators for the implementation of microenterprise programs.*** NGOs have experimented successfully with forming second-tier umbrella organizations, or associations. These national entities gather many NGOs to coordinate their strategies and programs, to provide technical assistance and training as well as to operate as financial intermediaries that on-lend funds to local NGOs. These associations develop consensus on the proper use of program methodology and maintain quality control among the programs within their membership. Financial intermediary associations are particularly effective because they can quickly identify and allocate resources to the programs that need them, monitor their performance, and graduate the microenterprise programs to obtain credit from commercial sources. Through the Association of Solidarity Groups, Colombia presents an example of one national association with over

6. 15 NGOs that has operated for over five years and continues to grow. Peru and Ecuador also present more recent examples.
6. ***Microenterprise programs conducted by NGOs currently represent a successful approach to extending credit and training to informal sector producers and retailers and should be incorporated into a national plan.*** Successful NGOs bring with them a series of characteristics that can accelerate the process of assisting the informal sector. For example, NGO program methodologies, such as the use of solidarity groups, have demonstrated their usefulness in reaching this sector and have the capacity to scale up in a significant way. Non - governmental organizations have also taken great strides in achieving self-sufficiency in their programs, an essential factor for long-term support to the informal sector. In the prccess, they have been successful in leveraging outside donor funds, as well as resources from the local private sector and commercial institutions.

At the same time, the majority of NGOs has maintained a high level of institutional integrity that has prevented programs from becoming politicized. Their staff is often considered dedicated and motivated by interest in working with this population. Therefore, corruption or misuse of funds seldom appears as a shortcoming in NGO programs. Finally, based on years of community-level work, NGOs have developed a trust relationship with the program beneficiaries which in part contributes to the success of their programs.

7. ***Strengthening the financial and managerial capacity of non-governmental organizations is a key ingredient for the expansion of successful microenterprise programs.*** While the characteristics listed above represent important advantages for implementing microenterprise programs, NGOs face considerable challenges if they are to play a significant role in extending services to microentrepreneurs. The need to scale up programs to reach tens of thousands of microentrepreneurs will require that NGOs increase their capacity and financial management capability beyond the current state. This implies human resource development, management

information systems, experimentation with improved methodologies, access to increased resources, and more. While in Latin America non-governmental institutions comprise the best prepared cadre of organizations to undertake a significant expansion in services to the informal sector, they nevertheless demonstrate deficiencies in key areas. These must be addressed through technical cooperation as part of a national strategy to enable them to play an effective role as program implementors.

8. Each donor organization must structure clear policies and strategies for assisting the informal sector. In addition, donor organizations must assume the responsibility of assisting governments to chart their own programs and policies. Donor agencies must perceive their role not only as resource providers but more importantly as innovators and planners that help increase a government's capacity to find effective ways to assist the informal sector. In some cases, donors can facilitate the replication of an approach that has been successful in one country. Issues such as the potential politicization of a program, the need for the government to coordinate national efforts, the inclusion of successful methodologies used by NGOs, and the urgency of reforming policies and regulations are areas where donors can play a significant role.

Bilateral and multilateral organizations can assist in this process by:

- encouraging governments to facilitate direct funding mechanisms to finance micro project activities that are identified and supervised by specific beneficiary groups;
- encouraging governments to play a major role in disseminating information on microenterprise development in the media, and making a public agenda to assist the productive activities of the poor;
- bringing international, national and local private organizations together to assist in the creation of a healthy environment among institutions that is based on dialogue among planners, researchers and practitioners; on sharing and standardizing program information; and on creating linkages in rural and urban areas among institutions.

These conclusions and recommendations represent an initial step towards the development of effective, well-coordinated, sustainable microenterprise programs in Latin America. Governments face many challenges as they venture into this relatively new area of activity. Likewise, non-governmental organizations must build on their experience and also overcome the constraints that have prevented many of them from becoming even more effective and far reaching.

The approach recommended here combines the expertise of implementing organizations with the resources and collaboration of the governments. It strongly suggests that effective responses to the informal sector will require the emergence of a model based on cooperation between government and non-government institutions. Finally, this approach constitutes an important manifestation of how institutions within a democratic structure can reach the poorer sectors of the society, work with representative associations among the poor, and accomplish more equitable development in each country.



**PART II**  
**COUNTRY STUDIES**

**COLOMBIA****A COLLABORATIVE EFFORT TO SERVE  
THE URBAN INFORMAL SECTOR**

Miguel Fadul

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**INTRODUCTION**

This essay summarizes the actions undertaken by the private and public sectors to promote small-scale economic units in the informal sector. The work the government has been engaged in since 1984 is intertwined with that of the private sector, making it artificial to separate the two. The work of both sectors has been based on a division of labor in which, generally, the state has been in charge of coordination, planning, and relations among the institutions, while the private sector has dedicated its efforts to the operational aspects, in which direct relations with the informal-sector target population are of primary importance.

This document recounts government and private-sector policies and actions to benefit the microenterprise sector. The results of programs that support the sector are examined, as are the relations between the sectors and the future prospects for collaboration.

The study is based on 25 interviews with government officials, professionals working with private organizations, microentrepreneurs, and people engaged in studying the informal sector in Colombia. It has been enriched by my experiences working with the National Planning Department

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**(DNP: Departamento Nacional de Planeación)** of Colombia, and by information from the data base maintained by the Inter-American Development Bank (IDB) on organizations working with the informal sector in Colombia.

### **COLOMBIAN GOVERNMENT SUPPORT FOR THE URBAN INFORMAL SECTOR**

Until 1983, government measures regarding the informal sector were limited to research projects and training programs carried out by the National Learning Service (**SENA: Servicio Nacional de Aprendizaje**). Since 1983, the government of Colombia has been more actively involved. The 1983-1986 National Development Plan placed priority on supporting the small enterprises of the informal sector. In early 1984, the National Planning Department set out to establish the first National Plan for Microenterprise Development (**PNDM: Plan Nacional para el Desarrollo de la Microempresa**).

The state's commitment to the sector is due in large part to the efforts of the influential director of the Carvajal Foundation, a private entity, and his lobbying of the then-president of Colombia. The Foundation had three years' experience providing training, technical assistance, and credit to small businesses and microenterprises, and felt that it was necessary to work more closely with the government for a variety of reasons including:

- the impossibility of establishing a massive program to serve the informal sector without government financial assistance;
- the role the state could play as an intermediary in obtaining international financing;
- the state's legitimation would facilitate support from local and regional governments, as well as from international institutions. In addition, the Carvajal Foundation and its affiliated foundations, as adjuncts of large Colombian businesses, considered that assisting the informal sector improves the image consumers have of the firms, especially when the state supports the efforts;
- the opportunity it would provide the foundations to influence government policy with regard to the sector.

As for the state, its principal reason for entering into the joint project was the pressing situation of open unemployment (14% in 1984). In a situation in which public spending was limited, due to the government's voluntary adoption of an International Monetary Fund adjustment package (1984), the informal sector's image as an efficient source of job creation was very useful.

In addition, the accomplishments of SENA were rather intangible. Very few microentrepreneurs had gained access to credit and there were no figures on how many had been trained. In this context, the government realized that the success of the private foundations could be considered a government success if the government actively participated.

In financial terms, the cost of initiating the program was limited to contributing \$1 million<sup>1</sup> annually to pay the foundations' operating costs, and allocating one full-time technical staff of the National Planning Department. Also, the Inter-American Development Bank made a commitment to capitalize a \$7 million microenterprise credit fund for the program.

### **Development of the Government Plans**

The government presented an analysis of the informal sector that constitutes the basis for its approach and identifies three specific populations to be addressed. One has to do with microenterprises and the families that operate them; another with workers and their well-being; and the last with the organization and actions of the institutions working with the informal sector.

Together, the microenterprises constitute a source of demand for capital goods and simple technology that can be produced in the country; a source of production of popular consumer goods that can help stabilize price levels; a means for decentralizing production; and the country's largest provider of employment.

The limitations on the potential contribution to the economy by the microenterprise sector are both internal and external to the sector. The first is poor management on the part of

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1. All monetary figures in this study are in U.S. dollars.

microentrepreneurs, largely due to their lack of familiarity with management and administration techniques. Along these same lines are limitations caused by imperfections both in the sources of information and in the financial markets. In this regard, poor use is made of existing technology, and there is a lack of knowledge of alternatives as well as a lack of access to institutional channels of credit.

The external or structural limitations are of various sorts. Some have to do with the inability of the small firms of the sector to make use of economies of scale in the purchase of inputs, product sales, and other areas. The others are based essentially on the illegal or paralegal status of the informal sector which separates it from the legal system with regard to labor and sanitary regulations, taxation, and other aspects.

For workers employed by microenterprises, any program must consider first and foremost that their situation is distinct from that of the microentrepreneur and the family. Improving the conditions of the latter does not imply that non-family workers will also benefit; a policy distinction is required. The two key issues are minimum wages and social security.

As for the institutions related to the informal sector, there are three problems that need to be resolved: the lack of coordination of the institutions, which gives rise to overlapping efforts and inefficient use of resources; the lack of sufficient operational financing for the foundations already working with the sector, leaving them unable to extend their coverage; and the inadequate credit funds that cannot meet the current and future demand for credit of microentrepreneurs.

As one would expect, the National Plan for Microenterprise Development is intended to resolve these problems. The formulation of this plan in 1984 was significant in the way in which it involved agencies from a variety of sectors, especially the non-governmental institutions that were already working with the informal sector. Ten foundations and private development organizations, 3 financial institutions, and 4 government agencies participated in designing the plan<sup>2</sup>. The plan calls for the formation of an Evaluation Council, which is to

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2. Departamento Nacional de Planeación, "Plan Nacional para el Desarrollo de la Microempresa: 1988-1990", 1988 (mimeo).

set guidelines for future actions, settle inter-institutional disputes, and serve as a forum to share experiences among institutions.

The National Planning Department continued to refine the plan until May 1988, when it was proposed that the process include two new actors: private institutions with methodologies distinct from those adopted by the original plan, and the organizations of microentrepreneurs. Beginning in 1988, as indicated in Appendix I, the National Plan for Microenterprise Development incorporated a broad range of agencies working with the informal sector.

### **Credit for the Informal Sector**

There are two sources from which the state has channeled credit to microentrepreneurs. The first is based on two lines of credit through the Popular Financial Corporation (**CFP: Corporación Financiera Popular**) in 1988, one from the Industrial Development Institute (**Instituto de Fomento Industrial**) for \$940,000, and the other from the Industrial Financial Fund (**Fondo Financiero Industrial**), for \$600,000. The second is the result of a government effort to obtain a \$7 million loan from the Inter-American Development Bank, which began to be disbursed in late 1988.

The funds are loaned by intermediate financial institutions to microentrepreneurs who have completed their training and have been recommended by the private foundations. The annual interest rate is 24% to 26%. In the IDB loan, half of the 24% interest is transferred to the foundations to pay operating costs and expand a guarantee fund for the loans; these funds are allocated by each foundation at its own discretion. In the other two credit lines the margin for foundations is only 6%.

In addition, in 1984 a fund was set up to finance the operational expenses of the foundations. This fund is composed of equivalent annual contributions from the DNP and the CFP. The fund lends a maximum of 10,000 pesos (\$88 in 1984) per trained microentrepreneur at 18% annually, with a grace period of 18 months. The foundations invest the credit in bonds that yield an average annual interest of 34%, which gives them a margin of 16% per microentrepreneur per year. As of late March 1989, the 13 participating foundations had a balance of approximately \$300,000 from this fund.

### Training for the Informal Sector

The task of overcoming the limitations of microenterprises related to administration and credit is almost entirely in the hands of the private institutions, although the National Learning Service (SENA) has the responsibility to serve those locales not reached by the private foundations. In addition, the private institutions use SENA advisors to carry out some of their training. There are no precise data on SENA's results, but it is estimated that from 1984 to 1987 it had trained some 13,700 microentrepreneurs.

SENA's average costs are shown in Table 1. These are based on the total payroll and therefore must be overestimated. Nonetheless, they reflect to some extent the high costs entailed in these programs.

**TABLE 1**

**COSTS PER PARTICIPANT AND PER GRADUATE FROM  
ENTERPRENEURIAL AND ORGANIZATIONAL  
TECHNICAL TRAINING IN THE SENA PROGRAMS  
FOR POPULAR PROFESSIONAL PROMOTION<sup>3</sup>**

AREAS	Technical Training (A)	Entrepreneurial Training in the Classroom (B)	Extension Entrepreneurial Training (B)
AVERAGE COST			
- Per participant per year (\$)	78	313	63
- Per hour of training	14	14	-
- Per graduate per year	100	400	104

(A) Training in technical areas in workshops.

(B) Courses given in the classroom in accounting, costs, marketing, and investment projects.

3. Ramírez, Jaime. *Programa de Formación Profesional para el Sector Informal Urbano en Colombia y Venezuela*, Montevideo, Cinterfor, 1988, p. 45.

In the area of technical education, SENA began to coordinate its work with the private institutions one year ago to provide technical assistance to the microentrepreneurs registered in the program. The assistance ranges from product design to the use of alternative technologies. Because this service is still in an experimental stage, its results have been limited; as of late 1988, 370 persons had attended training courses at 4 foundations, and 93 enterprises had received assistance in technical courses at two foundations<sup>4</sup>.

### **Other Forms of Support to the Informal Sector**

The PNDM Evaluation Council, in addition to defining the guidelines for policies, settling disputes, and facilitating communication, performs other functions. The Council established several committees for attending to particular tasks that have included the standardization of systems for serving microenterprises, and the development of a series of teaching aids. The Council also developed three models of information on the informal sector nationwide, which gave rise to an important series of studies on the sector. The guidelines for the IDB loan were drafted; the various foundations' experiences in marketing have been disseminated; a microenterprise information system has been established that is used for supervising the results of the different institutions' work; and different types of studies were financed to resolve specific problems of microentrepreneurs on a regional and national level.

The state also hoped to carry out legal reforms. Thus far, efforts relating to the legal regimen of microenterprises and their employees have been limited to studying the situation. Nonetheless, legislation was introduced to provide for tax advantages at the national level. The legislation was framed without input from the institutions that work with the sector, and is consequently being reformulated. In addition, the Ministry of Labor is being reorganized, with a special section to attend to informal-sector workers.

Two additional projects also deserve mention. The first has to do with initiating a study on metal mechanics work, which is

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4. Departamento Nacional de Planeación, Plan Nacional para el Desarrollo de la Microempresa 1988-1990, (mimeo).



being done with Japanese resources and personnel. The objective is to design a strategy for assisting the sector by increasing linkages with larger enterprises and enhancing the use of technology. The second is a program established by the Ministry of Public Works, with technical assistance from UNESCO and the sponsorship of the United Nations Development Programme. This program includes the establishment of microenterprise cooperatives in which both the members and workers are peasants. Each enterprise is in charge of the maintenance of a given stretch of national highway that passes through the local area. By 1988, there were already 248 microenterprises involved in this program.

### **Strengths and Weaknesses of the Government's Work**

The government's action has been determinant in several ways. The first is coordination among the various institutions in three areas: establishing an institutional means for channeling information efficiently; disseminating the experiences of the private sector in terms of marketing, methodologies, and teaching aids, as well as increasing standardization; and establishing a system through which the state can guide the foundations towards specific objectives consistent with the overall Development Plan.

The second has been overcoming the local and operational perspective of the private foundations. In general, the foundations are so immersed in their particular objectives relating to training goals, handling of funds, and others, that they lose sight of the big picture. Also, their limitations in terms of economic and political resources restrain them from going beyond solving the particular problems of microentrepreneurs to addressing the structural limitations. The government support has served as an impetus to move from solving internal administrative problems of microenterprises to addressing the legal, marketing, technological, and research problems, which are external to the microenterprises, but which affect the sector in general.

The major weakness of the government's program is its dependence on a reduced staff at the government coordinating body (DNP), and the staff's lack of autonomy. As a result, if one staff person leaves, or if there is a change in government, the capacity of the DNP is weakened and the program suffers. In

other words, there is no guarantee that the sector will continue to receive the current level of support.

The probability of program expansion is another limitation. Since the state is for the most part not responsible for operational aspects, expansion depends on the financial situation of the foundations and their particular motives and objectives. No matter how much the government insists on the importance of expansion, it does not have the power to carry it out.

Government action to increase funding for the operational costs of the foundations has been limited. To a large extent, this lack of funding has prevented further expansion of the programs. The financial contributions of the government have been marginal to its capacity. In other words, there is no comprehensive policy that includes legislative reforms and institutional support to unleash the potential of the informal sector. This lack of commitment reflects the reluctance of many government officials to opt for a solution that directly targets very small entrepreneurs, and the belief that small businesses can make only a limited contribution to the country's economic development.

### **SUPPORT FROM PRIVATE INSTITUTIONS TO THE INFORMAL SECTOR**

In general terms, the private institutions can be grouped in three categories: private foundations that use the Carvajal methodology; private foundations that use the solidarity group methodology; and private institutions from other countries. The first two work directly with microentrepreneurs, while the foreign institutions specialize in providing economic and/or technical support to the national foundations.

The Carvajal Foundation was the first to initiate major education and credit programs for small, informal businesses in the early 1980s. With IDB support, and through a network of private foundations, they brought their services to the different regions and cities of the country through a process of rapid expansion. In addition, the Carvajal Foundation initiated the efforts to involve the Colombian government in microenterprise programs. The organizations that share its methodology are an integral part of the PNDM, and enjoy the prerogatives of government financing mentioned above.

The Carvajal methodology is based on the belief that the small units are unable to grow because of the entrepreneur's lack of knowledge of management and sales techniques. With sufficient management tools, the microentrepreneur can learn to manage the business more efficiently. With additional assistance, he or she may succeed in overcoming marginalization and gain access to formal credit channels.

The target group is microenterprises that have potential for growth, but the educational opportunities are open to all. Microentrepreneurs must participate in courses in accounting, costs, marketing, and investment projects, and receive technical assistance in the workshop in which the subject matter is further clarified. In the last course each microentrepreneur designs an investment project for presentation to the bank for credit.

The foundations with the solidarity group methodology also have a network that covers a large part of the country, and which is coordinated by the Association of Solidarity Groups. These foundations were not included in the National Plan for Microenterprise Development until 1988. They have obtained resources with international assistance; to date the only government services they use are SENA advisors for some of their training.

The solidarity group methodology is basically geared to the lower-income social sectors, with the aim of increasing family incomes. The emphasis is placed on family well-being and developing relations within the community that foster development. The enterprise serves as an instrument for achieving these ends, as opposed to achieving increased production and efficiency, which are the objectives in the Carvajal method. These objectives are not discarded, but the emphasis in the solidarity group methodology is on solving the problems of poverty.

The methodology has the same three components noted above: training in management, technical assistance, and credit. However, the order in which they are delivered and the relative importance of the components is inverted to credit, assistance, and training. The participants have to form solidarity groups made up of 3 to 6 microentrepreneurs, which guarantee payment of the loans that each receives. The solidarity group component encourages the members to find

solutions to their business and other problems through the group. The foundations teach the participants how to nurture stable solidarity groups and serve as a source of credit for the groups. The foundations themselves manage the credit funds, since the resources belong to them.

Finally, there are two international private foundations, which are not fully addressed in this essay. They are ACCION International/AITEC of the United States, and the Ebert Foundation of Germany. The first manages the Association of Solidarity Groups, which provides technical assistance and training to the affiliated foundations, coordinates joint activities of the various institutions, and assists in fund raising, especially from international sources. The Ebert Foundation has begun to finance the foundations that market microenterprise products in Cali and Bogotá, and has established an institution that provides guarantees for the solidarity group loans based on the participants' savings.

### **Accomplishments of the Private Institutions**

The joint accomplishments of the private institutions, with both Carvajal and solidarity group methodologies, are impressive. From 1980 to 1986 they made loans to over 23,000 microentrepreneurs and intensively trained more than 33,000. On the other hand, it should be noted that the enterprises that have received assistance are but a small percentage of the 1,208,000 microenterprises (1984 figure) in Colombia.

### **Foundations Using the Carvajal Methodology**

The training and credit data are shown in Appendix II. These data are incomplete, as they do not include some new foundations for which there is no centralized information.

The data shows a general upward trend for all indicators from 1980 to 1985, and then a downturn which leveled out in late 1988. The initial growth was caused by a drastic increase in the number of affiliated programs, from one in 1980 to 14 by mid-1984. Also, the implementation of the PNDM appears to have energized the training and credit activities, either because of competition among the foundations, or because of the partial financing granted by the government.

The result was that the level of activities grew uncontrollably, without there being sufficient transformation or development within the foundations. The major foundations entered into internal crises that produced new directors (*Carvajal*, *Compartir*, and *Projuventud* Foundations), new organizational structures, and even a new methodology in one case. In addition, with the change in government and the consequent change in government officials, the IDB loan being negotiated at that time became bogged down, and many foundations found their ability to make loans to microentrepreneurs restricted. There was a sudden drop in all of the indicators, which now appear to be stabilizing.

Despite this fluctuation, the figures for training are impressive, with 141,000 persons attending microenterprise courses. Nonetheless, this figure appears to be inflated, since it is the sum of those who attended the four basic courses. If an entrepreneur attended all four courses, he or she was counted four times. Furthermore, when entering the courses, the microentrepreneur can send one or more family members or others working in the microenterprise; therefore the number of people who actually attended courses is somewhat greater than the number of microenterprises served, which was 33,461.

The programs make approximately 2,000 loans to microenterprises each year; a total of 10,239 loans have been granted since the Carvajal programs began. The figure is low in relation to the number of microenterprises that received training, and shows the emphasis that this methodology places on training instead of credit. Training costs, which have been decreasing in dollar terms, are high, but apparently less than those of SENA (Table 1). The average cost for training was \$149 per microentrepreneur, as compared to \$313 per entrepreneur per year for SENA. The high cost of training is also reflected in the cost per dollar loaned of \$.51 in 1988. The high costs tend to make aggressive expansion of the program difficult.

The average number of employees per microenterprise, 3 to 4.6, is much greater than the national average of 1.7, indicating that the program is reaching larger-than-average enterprises. Thus far there is no system in place for measuring the programs' impact on employment and incomes, but such a system may soon be implemented, with the help of a National Information System which is being developed.

### Foundations Using Solidarity Group Methodology

The solidarity group programs cannot be measured with exactly the same indicators as the Carvajal programs, since each individual who participates in a solidarity group program receives a loan. Nonetheless, other compatible indicators can be examined (Appendix III).

As of 1988 the solidarity group programs had delivered loans to 4,281 groups made up of 15,775 individuals. That they made a total of 29,548 group loans reflects the particular methodology of these programs. A group receives a very small initial loan for a short period of time, a matter of weeks, and then, if a good payback record is maintained, they may receive progressively larger follow-up loans with longer payback periods.

All of the indicators in Appendix III show systematic and substantial increases. The amount of savings has been included, since the programs require that the microentrepreneur have a minimum initial level of savings which serves as the basis for guaranteeing the first loan. When the loan is repaid, these savings can be used at the discretion of the microentrepreneur.

The cost per amount loaned is 6%. Even though these calculations do not include all of the assistance costs incurred by ACCION for the Association of Solidarity Groups, the cost at the program level is very low. The 75% rate of self-sufficiency may also be overestimated, but the trend is toward operational self-sufficiency of the programs. This high level of self-sufficiency makes it possible to expand without depending completely on external financing. What remains to be seen is whether this approach can be adapted to larger enterprises on a massive scale. Some foundations have embraced both the Carvajal and solidarity group methodologies for working with different types of microenterprises, such as the *Fundación Barranquilla* and *Projuventud*.

The average loan amount reflects the major difference in the type of microenterprise served in the two methodologies. The average loan is for \$130, as compared to \$1,070 for the enterprises with which the Carvajal methodology is used.

The impact indicators are more detailed in this methodology; since 1986 three surveys have been carried out and the results

are shown in Appendix IV. Employment, in these surveys, increases by one per microenterprise. Considering that the largest microenterprises accepted in this program are those with three employees, the increase is from 33% to 100%, depending on the size at the outset. Family income also tends to go up, as business incomes increase 45% and 57% in commerce and production respectively.

### **Strengths and Weaknesses of the Private-Sector Work**

The greatest contribution of the private institutions in their work with the informal sector has no doubt been their dynamism. The private sector has contributed the methodologies, ideas, and the example of their direct work with small enterprises. The private institutions undertook the first lasting efforts to work with microentrepreneurs, and are responsible for the current level of support to the informal sector, both ideologically and pragmatically.

The private institutions have caused a snowball effect, as their methodologies have been copied by a number of institutions and propagated throughout the country. Their dynamism stirred the state from its operational lethargy. In addition, they have invested much more than the public sector in implementing their programs, and are an example for international financial institutions. What began as a local effort to resolve the problems of employment and low income has turned into a development alternative for the most underprivileged sectors, and an opportunity for progress for thousands of smaller entrepreneurs.

Furthermore, they have contributed practical examples for solving problems in the microenterprise sector, such as marketing, without requiring substantial external financing. This precedent may be replicated on a larger scale, as both the government and some international organizations have understood the importance of local solutions.

The limitations of the private programs are inherent to their size and are essentially financial and logistical. The programs tend to be immersed in the local realities where they work, and their long-term vision tends to be restricted to very specific objectives of limited scope.

Due to the fact that many of the foundations that work with the Carvajal methodology are sponsored by large companies

with substantial capital, their interest in diminishing operating costs, which appears necessary for their expansion, has been minimal. However, the new methodology of solidarity groups may yield lessons that make it possible to qualitatively expand the programs. The problems that arose in 1984 with the foundations using the Carvajal methodology, when the population served doubled from one year to the next, showed that a greater effort to expand requires an internal organizational change, as well as a search for alternative financing sources.

Another weakness of the private programs is that their objectives are not clear. The foundations working with the Carvajal methodology aim to provide training to all microentrepreneurs, but they provide financing only to those with the greatest economic potential. This policy does not help alleviate poverty, since the investment in training the small entrepreneurs is sometimes for naught, since the entrepreneurs become frustrated upon not receiving credit. Moreover, the owners of the enterprises that have great potential for growth have incomes far above the poverty line. In other words, they are the richest of the poor. Nor do the Carvajal programs fully dedicate themselves to promoting the enterprises with the greatest potential, as a part of their budgets is for training all microentrepreneurs, and this investment diminishes the financial capability for better serving the larger ones. These foundations need to define their respective objectives, and fully focus their energies on accomplishing those objectives.

As for the foundations working with the solidarity group methodology, they are mostly supporting subsistence enterprises, most of which operate in competitive markets. Support to enterprises that operate in these markets can have only two effects: either the enterprises facing the highest costs will be eliminated, or prices will come down throughout the sector. The result is the erosion of incomes for all entrepreneurs in the sector. In other words, the programs' benefits have been limited to the microeconomic level, and the positive effects obtained at this level may not apply at a more aggregate level.

For programs working with either the Carvajal or solidarity group methodology, there is a need to clarify short- and long-term objectives, and to differentiate among the services, bearing in mind the sector's characteristics and those of the microenterprises.



## **RELATIONS BETWEEN THE STATE AND THE PRIVATE SECTOR**

As was indicated at the outset, the policy approach to the informal sector has essentially been one of cooperation. The state, with the leadership of the National Planning Department, has sought the gradual incorporation of all of the institutions, and even of the microentrepreneurs themselves, in a single institution. This inclusionary mechanism has already been consolidated and current efforts focus on improving it.

The relations have had their share of clashes and disputes, but such situations have not been exclusively between the public and private sectors. In the process of consolidating the National Plan for Microenterprise Development, the private foundations have participated in turf battles among themselves, and it appears that another confrontation is ensuing regarding the primacy of one methodology over the other. The main contribution that has resulted from the joint work has been to create a forum for discussion in which the disputes are settled by mutual agreement, and not through confrontation.

A large part of this success can be chalked up to the mutual need of the two parties involved, as the state needs the private foundations to increase coverage, and the private foundations need the means and instruments available from the state for financing.

Even though relations between the government and the private foundations are excellent, the centralist structure of the government has emerged as a negative factor in the relationship. This structure has not favored local and regional integration of the government's policies and programs. Consequently, the foundations, with their local contacts, have had to establish their own direct relations with local governments. This process has not permitted a systematic expansion of the programs to different localities.

### **Relevance of the Colombian Experience to Other Countries**

The key question that must be posed is not whether or not collaboration between the state and private programs is desirable. The key question is what type of collaboration, and

with what means, within the specific limitations of each country. The response must bear in mind the following parameters, among others:

- What is the division of work between each institution? An appropriate division of labor and a complementary relationship should result from cooperation. This distribution will prevent competition, which could lead to a weakening of the various efforts.
- What are the characteristics of the institution with which one is going to work. The case of the DNP is very indicative, as it is a purely technical agency whose "natural" function is not to implement programs but to coordinate and set priorities based on the overall Development Plan. The role of the Ministry of Development would have been quite different, for in its case politics and particular interests prevail. The government is not homogeneous; this is particularly important to bear in mind.
- What is the organizational system through which cooperation is put into practice? The formation of the institutions and the functions assigned within each of them may determine the level of success.

Nevertheless, no ideal organization or model can be identified. The Colombian case, as with all social situations, has been marked by particular features that have determined the process: the respectability and tenacity with which the director of the Carvajal Foundation pursued his objective of collaboration, the atmosphere of policy coordination that characterized government action, the professionalism that has characterized DNP staff, and the wealth of human resources of most of the participating institutions. The process must take its own course in each country, accounting for the national characteristics and situation.

### **Future Outlook**

Prospects for the future are centered on the work of coordinating the various institutions involved with the urban informal sector. For better or worse, the scheme that has been established is difficult to abandon; any future alternative should be developed on the basis of this organizational structure.

In general, there are reasons for optimism and others not so encouraging regarding the future of joint efforts directed to the informal sector. Optimism is generated by the gradual but advancing political, budgetary, and administrative decentralization, which confers greater autonomy in local administration and local government purchases. In the small municipalities, local governments will purchase from small enterprises, since purchases from that sector bring a greater political return (more vote at less cost).

The process is already underway in some of the larger cities, such as Cali, where a municipal regulation stipulates that 40% of the municipalities' purchases must be from the microenterprise sector. The other side of this process lies in the program's potential susceptibility to politicization, which could cause a decline in services and neglect of the initial objectives proposed by the foundations. In addition, the explicit inclusion of the informal sector in the candidates' political discourses for the 1990 elections, may be both a strength and a weakness.

The inclusion of new entities with different methodologies into the existing Plan is also encouraging. Both the marketing units that have been created and the solidarity group programs have injected new dynamism into the Plan, and will force a healthy questioning of the methods and objectives in the medium term. Nonetheless, a process is underway in which these groups are pressuring without there being any need for them to do so, and the traditional foundations are feeling resentful, also unnecessarily. The manner in which the new groups are included may determine the outcome, and if the perspectives become polarized, irreparable damages may occur. An awareness must be fostered that the two methodologies are not contradictory, and that their target population is essentially different.

There is clearly a growing interest in the Colombian program on the part of international agencies that fund projects to assist the informal sector, which may prove beneficial. These range from Women's World Banking, which offers resources for financing subsistence sector activities that involve women, to the governments of Germany and Japan, which are providing technical cooperation and contributing new resources. Even though this aid is helpful, one must bear in mind the importance of the participants themselves assuming the process as their own, since such aid is always limited.

There is some reason for pessimism over the process of institutional integration, which is worth reiterating. This pessimism is rooted in the project's considerable degree of dependence on coordination provided by the National Planning Department, and the lack of continuity in the DNP's staff and policy. The task that has been put in the hands of the DNP to date has been coordination. As the program expands, it is more difficult for the DNP to limit itself to this function. Over time, an effort is to be made to overcome this limitation, gradually transferring the new tasks to the Ministry of Development. Before making this change, however, the program must be strengthened to prevent damage during the transition. In addition, presidential elections are approaching, and in the wake of the elections there will be new personnel at the DNP. This will be a crucial test of the survivability of the program.

We hope that the future will prove the optimists to be right, so that today's handful of hopes may continue to evolve.

## APPENDIX I

AGENCIES INTEGRATED INTO OR RELATED  
TO THE 1988-1990  
PLAN FOR MICROENTERPRISE DEVELOPMENT

## NON-GOVERNMENTAL ORGANIZATIONS

AGENCY	AREA OF COVERAGE
<b>Registered in Plan</b>	
Fundación Carvajal	Cali, Yumbo, Dagua
Corporación Microempresas de Antioquia	Medellín metropolitan area
Fundación Compartir	Bogotá
Fundación Mario Santo Domingo	Barranquilla
Fundación Social	Bogotá/Ibagué/Nieva/Pasto
Fundación Sarmiento Palau	Tuluá/Cartago/Bugalagrande/Buga
FUNDESAN	Bucaramanga
CORPOCAUCA	Popayán
CORPOCALDAS	Manizales
FUNDELPA	Buenaventura
FUNDENOR	Cúcuta
FUNDICAR	Riohacha/Maicao/Villanueva/San Juan del Cesar/Fonseca
FUNDECOOP	Bogotá
Fundación Santa Helena	Bogotá
Fundación Círculo de Obreros	Cartagena
Fundación Cultivar	Bogotá/Norte del Tolima/Magdalena Medio
FUNDAEMPRESA	Cali
CORFAS	National
Corporación Acción por Antioquia	Medellín
Corporación Acción por Tolima	Ibagué
Centro de Desarrollo Vecinal	Cartagena
CIDES	Bogotá/Manizales
Fundación Familiar	Cali
F.W.W.B. Colombia	Cali
F. Mundial de la Mujer	Bucaramanga
Corp. Mundial de la Mujer	Medellín

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**In the process of registering in the Plan**

Corporación Acción por Bogotá	Bogotá
Fundación Pisingos	Bogotá
Corp. Mundial de la Mujer Colombia	Bogotá
Fundación Mundo Mujer	Popayán
Fundación Shell	Bogotá
Microempresas del Quindío	Armenia
Microempresas de Palmira	Palmira
FUNDESARROLLO	Bogotá
FUNDECOR	Montería
Fundación San Isidro	Montelíbano
Fund. para el Desarrollo de Risaralda	Pereira
Plan Padrinos	National
FUNDENORVALLE	Roldanillo
COTECA	Dept. of Nariño
AGAPE	Atlantic Coast

**SPECIALIZED SERVICE AGENCIES**

Promotora de Comercio Social Procomercial	Medellín
Sistema de Información Comercial para el Sector Microempresarial	Valle del Cauca
Fundación para el Desarrollo de la Microempresa	Valle del Cauca
Fundación Promotora de Servicios Microempresariales	Bogotá

**OTHER AGENCIES**

Chambers of Commerce	Several cities
Fundación para la Educación Superior	Cali, Bogotá

**PUBLIC AGENCIES LINKED TO THE PLAN**

Departamento Nacional de Planeación  
Ministerio de Desarrollo Económico  
Ministerio de Comunicación  
Departamento Nacional de Cooperativos  
Servicio Nacional de Aprendizaje  
Artesanías de Colombia  
Corporación Financiera Popular  
Banco de la República

**INTERNATIONAL TECHNICAL COOPERATION AGENCIES**

Inter-American Development Bank  
UNDP-UNIDO  
Friedrich Ebert Foundation of Colombia - SEDECOM  
ACCION International/AITEC

**APPENDIX II**

**RESULTS OF PROGRAMS THAT USE CARVAJAL  
METHODOLOGY**

Indicator	1980	1981	1982	1983	1984	1985	1986	1987	1988	TOTAL
Courses Given	23	105	284	521	931	1.752	1.590	1.352	1.541	8.099
No. People Attended	429	1.785	4.907	9.852	14.361	29.677	26.098	24.845	29.374	141.328
No. Microenterprises Trained	133	453	798	1.493	5.468	6.885	5.868	5.893	6.470	33.461
No. Accounting Systems Est.	325	1.504	2.647	3.133	4.210	6.146	5.456	5.577	6.972	35.970
Drop-out Rate (%)	0	81	79	59	70	30	23	23	20	37
No. of Loans Disbursed	86	187	450	952	1.162	1.763	1.792	2.082	1.765	10.239
Amount Disbursed (\$)	105.772	248.967	599.088	1.217.103	1.518.730	2.142.967	1.876.123	2.175.263	1.890.183	11.774.196
No. Loans/Trainee (%)	65	38	47	52	18	22	21	25	21	24
Active Portfolio (\$)	95.077	212.676	679.777	1.258.495	1.646.705	2.280.315	2.041.784	2.294.024	N/A	
Average Loan Size (\$)	1.230	1.331	1.278	1.307	1.216	1.047	1.045	1.071	1.150	
Arrears/Active Portfolio (%)	0	0	2	10	7	12	12	11	N/A	11
Employees per Enterprise	4,07	3,41	3,51	4,04	3,00	4,20	3,15	4,46	4,64	3,95
Cost per Loan (\$)	887	1.324	968	812	888	627	563	516	547	656
Cost per \$1 Loaned (\$)	.72	.99	.73	.63	.68	.52	.54	.49	.51	.57
Cost per Trainee (\$)	573	547	546	518	189	161	172	182	149	201
No. of Staff in Programs	10	31	44	100	162	166	153	154	N/A	154

APPENDIX III

RESULTS OF PROGRAMS WITH SOLIDARITY  
GROUP METHODOLOGY

INDICATOR	1983 (5 months)	1984	1985	1986	1987	1988 (8 months)	1989	TOTALS
No. of Training Meetings	41	317	955	1.519	1.952	2.099	1.874	8.757
No. of Groups Receiving Loans	94	271	664	565	731	1.020	936	4.281
No. of Enterprises in Groups	322	1.019	2.264	1.919	2.807	3.852	3.592	15.775
Total No. of Loans to Groups	190	2.050	4.619	5.130	5.691	6.611	5.257	29.548
Amount Loaned (\$)	38.325	539.859	741.085	1.141.387	1.799.107	1.899.526	1.419.518	7.578.807
Average Amount per Group (\$)	202	263	160	222	316	287	270	256
Average Amount per Person (\$)	69	68	47	70	87	85	73	74
Active Portfolio (\$)	15.209	60.678	168.675	265.617	462.489	684.470	783.546	783.546
Arrears/Active Portfolio (%)	1	10	20	10	10	11	8	8
Balance of Savings Fund (\$)	1.812	23.170	27.652	15.517	55.983	65.440	82.805	82.805
Cost/Total Amount Loaned (%)	4	8	7	6	4	5	6	6
Operational Self-Sufficiency (%)	2	20	35	70	73	75	75	75



## APPENDIX IV

## IMPACT INDICATORS: SOLIDARITY GROUP PROGRAMS

	Merchants	Producers
Average increase in purchases	37.66%	7.08%
Average increase in sales	29.69%	23.79%
Average increase in business expenses	16.09%	.15%
Increase in nominal income	45.48%	57.77%
Average number of jobs generated per enterprise	1.06	1.33
Beneficiaries who keep accounting records		
Survey 1	39.89%	50.13%
Survey 2	48.49%	63.32%
Survey 3	49.90%	61%
Beneficiaries who have improved the workplace		
Survey 1	35.30%	24.09%
Survey 2	29.04%	22.83%
Survey 3	31.87%	32.57%
Beneficiaries who have acquired new equipment		
Survey 1	16.68%	21.19%
Survey 2	15.45%	29.15%
Survey 3	13.83%	18.61%
Beneficiaries who assert they are applying new knowledge		
Survey 1	82.82%	74.59%
Survey 2	80.64%	78.80%
Survey 3	74.18%	76.77%

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## ECUADOR

### GOVERNMENT AND PRIVATE PROJECTS FOR MICROENTERPRISE DEVELOPMENT

Santiago Carrasco

Santiago Carrasco is a respected researcher of topics related to Ecuador's development process. He received his Masters in Business Administration from Boston College in Massachusetts and was Executive Director of the Fundación Eugenio Espejo for five years. He recently conducted an evaluation of non-governmental organizations implementing microenterprise projects in Ecuador.

#### INTRODUCTION

The Government of Ecuador has shown a positive interest in the informal sector of the economy for over five years. This interest has been demonstrated by a series of legal and institutional actions seeking the most appropriate responses to this socioeconomic issue.

The private sector has also been paying attention to this growing portion of the economy. Some organizations have implemented programs involving informal sector entrepreneurs, either directly or indirectly, for more than ten years. In addition to foundations and non-profit organizations, a financial institution, the Bank of the Pacific (*Banco del Pacífico*) has opened special credit lines for informal sector businesses.

This document summarizes the public and private sector programs designed to support the development of informal businesses. The study is based on available research about the informal sector in Ecuador and a series of interviews with the directors and several employees of two government programs. Documentation from these programs was also reviewed. In addition, interviews were conducted with personnel from four non-governmental organizations (NGOs) in Quito, six in Guayaquil, and one in Cuenca.

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## THE GOVERNMENT AND THE INFORMAL SECTOR

### Government Programs

The ministries that have taken initiatives in this field are the Ministry of Labor and Human Resources and, more recently, the Ministry of Social Welfare. Both have formed specialized units and promulgated decrees establishing a legal basis for their actions. Both programs include private institutions that work with the informal sector, indicating the government's willingness to cooperate with the non-governmental organizations.

#### National Microenterprise Program

The National Microenterprise Program (UNEPROM) was established in January 1986 by the Ministry of Labor and Human Resources to: coordinate private and public assistance to microentrepreneurs; provide technical assistance for obtaining and channeling resources from national and international agencies; and offer advice regarding the study and design of credit lines for microenterprises<sup>1</sup>. UNEPROM's policies, redefined in September 1988, emphasize: organizing producers into groups; engaging microenterprises in production; providing comprehensive support to microenterprises through training, credit, technical assistance, and follow-up; reaching secondary cities and rural microenterprises; and channeling credit through private financial intermediaries.

UNEPROM receives support from the Ecuadorian government as well as national and international agencies. The program received UNICEF funding for women's programs, and AID funding for training, technical assistance, and a credit fund.

An important component of UNEPROM is the Microenterprise Sector Development Fund (**FODEME: Fondo de Desarrollo del Sector Microempresarial**), established to channel financial and technical resources to informal-sector enterprises. UNEPROM has established formal credit funds for microentrepreneurs through agreements with several private and public banks, including the National Development Bank (**Banco Nacional de Fomento**), **La Previsora**, and **Los Andes**.

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1. Ministry of Labor and Human Resources, National Microenterprise Program, Draft brochure for dissemination, Quito, 1989.

Loans to microentrepreneurs from the National Development Bank are made at preferential annual interest rates of 32% for a two year period with quarterly amortizations. The maximum amount loaned is the equivalent of 30 times the minimum monthly salary or 810,000 sucres (\$1500 in 1989)<sup>2</sup>. Through private banks, loans are disbursed at an adjustable interest rate starting at 36% for one year for working capital and two years for the purchase of fixed assets. Loan payments are due on a monthly or quarterly schedule, and the maximum loan is 20 times the minimum salary, or \$1000 for working capital. For fixed assets, the maximum loan is 36 times the minimum salary, or \$1800. For groups, the maximum amount is 100 times the minimum salary (\$5000).

The financial resources are channeled through the banks to the microentrepreneurs who then receive training and technical assistance from NGOs. From 1986 through 1988, UNEPROM was not fully functional and there was very limited loan activity. However, from 1988 to date, credit agreements have been signed for more than \$480,000, fifty percent to be contributed by the private banks and the other half by UNEPROM.

In addition, from November 1988 to March 1989, the Ministry signed training and technical assistance agreements with 14 NGOs. These organizations work in all parts of Ecuador, including 10 provinces, Quito, Guayaquil, and intermediate cities. The fourteen agreements valued at \$323,420, are expected to benefit 11,000 microentrepreneurs, and it is estimated that in 1989 alone they will benefit approximately 15,000 people. As of September 1989, 7535 people had been trained.

UNEPROM has also carried out other activities for microentrepreneurs including: publication of microenterprise training manuals, provision of legal services through the Catholic University of Guayaquil, and the completion of an international seminar and national workshop entitled "Training Personnel to Support the Informal Sector."

### **The National Corporation to Support Popular Economic Units**

In 1988, the Government of Ecuador established, by Executive Decree, the National Corporation to Support Popular

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2. All currency figures have been converted to dollars.

Economic Units (**CONAUPE: Corporación Nacional de Apoyo a las Unidades Populares Económicas**). The "popular economic units" are urban and rural informal sector microenterprises. The CONAUPE board of directors is composed of highly qualified individuals, including two cabinet ministers, the manager of the Central Bank, and the Secretary of the cooperative system. It also includes two representatives from associations of microentrepreneurs, one from the coast and one from the sierra.

CONAUPE's objectives include direct support for the informal sector and policy changes to improve the milieu in which microenterprises operate. Specifically, in the next 36 months, CONAUPE hopes to:

- Facilitate access to institutional credit for at least 60,000 popular economic units (UPEs), and increase their assets and incomes by 80%.
- Create new jobs.
- Provide some degree of professional training for 50,000 UPE workers.
- Improve the organization of UPEs and the legal status of such organizations; implement self-managed development programs and leadership training in at least 500 UPEs.
- Improve the legal standing of 50% (30,000) of the UPEs.
- Propose legislation that improves social security in the UPEs.<sup>3</sup>

The CONAUPE methodology promotes the participation of public and private entities, especially the UPEs and their organizations. These entities may be organizations specialized in training and technical assistance, financial, or insurance institutions. CONAUPE will channel credit through the banking system, and also provide guarantees. The banking system assumes the commitment of providing credit to the UPEs. The UPE's organizations will participate in managing the credit

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3. Project ECU/89/001 - MBS/UNDP/ILO-PREALC, "Propuesta para el Plan Inicial de Trabajo del Programa Nacional y Masivo de Apoyo a las Unidades Populares Económicas del Ministerio de Bienestar Social y la Corporación Nacional de Apoyo a las Unidades Populares Económicas", Consultative Document, Quito, 1989.

funds, and create Credit Committees who will be trained by CONAUPE. The program emphasizes training the entrepreneurs and the leaders of their organizations so that they can assume the responsibilities of managing credit and coordinating activities to benefit the sector.

### **Opinions: The Public Sector and Microenterprises**

Popular opinion supports the initiative of the Government of Ecuador to become involved with the informal sector. As indicated above, the government has taken action to organize programs to work directly with microenterprises.

Of those interviewed for this essay, some have not had any contact with governmental programs; they are not familiar with either UNEPROM or the lines of credit from the National Development Bank. Initially, their agency or entity was approved by a governmental authority, but there has been no further contact. Neither they nor their beneficiaries have been impacted by UNEPROM.

Others had a working relationship with UNEPROM and the National Development Bank. Generally, those that have had experience with the National Bank have had negative experiences and are seeking credit from other sources. The bureaucracy of the bank and its slow pace of operations have sent these agencies to other banks or cooperatives. The National Development Bank focuses its energies on formal sector lending. Its organizational structure, operations, and methodology, even for analyzing credit, are much more suited to the formal sector, and are not appropriate for the microenterprise sector.

Other organizations, however, have had a positive relationship with UNEPROM. In some cases UNEPROM is the agency that approved their by-laws and allocated the first resources for training and technical assistance services. The beneficiaries of such resources have gone on to obtain microenterprise credits from private banks. The UNEPROM program has enabled these organizations to operate and function, and in some cases even to exist.

Another positive aspect of UNEPROM has been its effort to promote microenterprises, publicizing their existence and pointing out their problems, achievements, and potential

benefit to the economy. The Ecuadorian community knows what microenterprises are, the contributions they can make to society, and the value of programs that support them.

Some interviewees were skeptical as to UNEPROM's ability to operate, especially in the area of credit. Although UNEPROM has placed priority on training since its inception, its influence as an intermediary provider of bank credit was negligible until 1988 and has not been effective since that date. A microenterprise program that does not provide credit has no real function and leads to growing frustration, among both NGO staff members and microentrepreneurs.

There is confusion within the sector as to whether there is one government program or two. If there are two separate programs, will there be coordination between them? Both aim to be broad-based programs, providing credit, training, organization, and other services. If there is no coordination, there will be a major duplication of efforts and a lot of confusion among the NGOs and the microentrepreneurs themselves.

Some of the people interviewed believe that the government itself is not clear on what its role should be regarding the informal sector, and what role corresponds to the private sector. According to some, the government should dedicate itself to setting policy to regulate the informal sector operations, and to making the substantive reforms that enable microenterprises to operate smoothly. Such reforms should be legal, administrative, institutional, and procedural. For example, for artisans to have access to some advantages that have been provided for them, they must become officially affiliated as artisans. This process is beyond the reach of many artisans due to cost, bureaucratic red tape, and the requirements for acceptance. Another example is the way in which banks operate and their requirements for disbursing a loan. Banks require guarantees, which prevent microentrepreneurs from obtaining small loans. In both cases reforms are necessary to ensure that the system does not inhibit microentrepreneurial activity.

In sum, although the government expresses interest in supporting the informal sector, and its efforts focus a great deal of attention on the sector, it has not been able to measurably impact the sector. Its policy towards the sector has not been defined, and there is confusion as to the relationship between the two governmental programs and the NGOs. The UNEPROM

program has not elaborated an efficient methodology that enables it to reach many microentrepreneurs, while the CONAUPE program is still in the planning stage.

### **SUPPORT FROM PRIVATE INSTITUTIONS TO THE INFORMAL SECTOR**

There are approximately 53 non-governmental institutions, approved by different ministries, working to support the informal sector in Ecuador. In practice, the number is much smaller.

The decrees establishing non-governmental agencies and their by-laws spell out very general objectives and purposes, yet these statements are not always reflected in activities. Generally, the by-laws do not establish quantifiable goals which would enable a meaningful measurement of results.

Only a few organizations have provided quantitative information on their work with microenterprises. Most simply indicate their interest in microenterprise activities. A small group of organizations has been engaged in such work for less than a year, and thus cannot provide relevant information. Nonetheless, there are four organizations that must be identified as the microenterprise pioneers in Ecuador.

#### **Bank of the Pacific (Banco del Pacífico)**

The Bank of the Pacific has been working with microenterprises for more than 10 years. Its primary activity is the provision of credit, and some advisory services for managing credit. The program has taken on a new impetus in recent years: more promoters have been contracted, vehicles have been purchased, and the program has been extended to other cities. Unfortunately, information about the number and amounts of microenterprise loans disbursed by the bank has not been made available.

#### **The Ecuadorian Development Foundation (FED: Fundación Ecuatoriana de Desarrollo)**

Established 21 years ago, the FED began to work with microentrepreneurs in 1984, and is affiliated with ACCION International/AITEC. It has a credit program in Quito that has been strengthened with a loan from the Inter-American



Development Bank (IDB). The program has made loans to more than 1,600 microentrepreneurs, has a late payment rate of less than 3%, and covers the operational costs of the credit program with income from that same activity. The success obtained with the new resources and the high rates of recovery and efficiency make the program noteworthy.

### **The Eugenio Espejo Foundation (Fundación Eugenio Espejo)**

Established in 1980 in Guayaquil, this foundation also began to work with microentrepreneurs in 1984, when it became affiliated with ACCION. Its activities are national with microenterprise programs in the City of Guayaquil and in the marginal areas of Babahoyo. These projects were made possible by financing from UNICEF and the Inter-American Foundation. In 1988, the program made loans to over 400 microentrepreneurs, had a late payment rate of less than 5%, and covered a substantial amount of its operating costs with income from the loan fund. The Foundation also implemented a special program, through an agreement with UNEPROM, to train 4,000 microentrepreneurs from Guayaquil during 1985 and 1986.

### **The Guayaquil Foundation (La Fundación Guayaquil)**

This foundation was legally constituted four years ago, although it had four years' prior experience with a program sponsored by the United Nations and the International Labor Organization. Its microenterprise program was initiated through collaboration with UNEPROM and received initial funding through that institution, and has since been supported by the IDB. The Foundation has not provided numerical data on its activities, asserting that the program's emphasis is on development and qualitative results rather than quantitative results.

As was mentioned, there are many smaller and more recent initiatives than those described above. A few of them are mentioned below to give the reader an idea of the variety and number of agencies working with the informal sector throughout Ecuador.

- o The Austral Foundation for Microenterprise (**FADEMI: La Fundación Austral de Microempresas**), established in 1988,

provides training, credit, and legal, accounting, and marketing assistance in the southern sierra and eastern regions.

- o The Ecuadorian Chapter of the International Council for Women (**CECIM: Capítulo Ecuatoriano del Consejo Internacional de Mujeres**) has organized training courses and promoted microenterprise credit for low-income women in the Guayaquil area. It has implemented some training and credit programs with assistance from UNEPROM.
- o Center of Promotion and Employment for the Urban Informal Sector (**CEPECIU: Centro de Promoción y Empleo para el Sector Informal Urbano**). For more than a year CEPECIU has been implementing various training, technical assistance, and credit programs with UNEPROM support. It has also carried out several special projects and research projects related to microenterprises.
- o Institute for Socioeconomic and Technical Research (**INSOTEC: Instituto de Investigaciones Socio-económicas y Tecnológicas**). INSOTEC activities are carried out nationally with an emphasis on marginal areas of intermediate cities. The projects have been geared to technical assistance, credit for microenterprises, and educational research.
- o CARE has begun a new microenterprise program in secondary cities, with advisory services and cooperation from the Carvajal Foundation of Colombia.

The following table shows the results of some of the programs mentioned above:

Entity	Number of Participants	Number of Loans	Total Amount Loaned (\$)	Number Trained
FED (1988-89)	2,550	NA	556,000	2,530
Espejo (1988-89)	1,537	2,321	142,000	3,954
Guayaquil	NA	1,069	82,000	1,091
FADEMI	1,200	NA	558,000	3,500
CECIM	1,362	104	NA	245
CEPECIU	1,195	NA	121,000	NA

**Opinions: The Private Sector and Microenterprises**

It was the private agencies that first began to work with microenterprises, initially the Bank of the Pacific some ten years ago, and the Ecuadorian Development Foundation and Eugenio Espejo Foundation five years ago. These entities have shown the way to serve microentrepreneurs with training, technical assistance, and credit. In addition, they have shown a capacity to experiment with new methodologies and to change methods or approaches to bring about better results in their work with the microenterprise sector.

The NGOs clearly have evolved in terms of the content, scope, and methodology of their microenterprise programs. Top-notch development experts have been recruited by a variety of NGOs; they have displayed administrative efficiency and a solid social, economic, and cultural orientation. The NGOs' participation in project administration is ever more extensive, due to some very positive characteristics of the sector: the absence of a profit motive, the limited bureaucracy, the lack of ties to political or organizational interests, the potential to hire quality professionals and technical experts, and their dedication to service activities and research and scientific activities. The private organizations have become key organizations for the microenterprise sector.

Despite these positive aspects, the people interviewed for this study recognize that the private agencies have some limitations. First of all, the NGOs lack economic resources, which limits their activities, makes them less effective, and stands in the way of medium-term planning. None of the NGO programs have grown to a level beyond what might be called the pilot project stage. Few reach more than several hundred microentrepreneurs.

Another weakness, related to but not responsible for the lack of resources, is that the private financial and business sector, with some exceptions, has not been forthcoming with support for the NGOs and the microenterprise sector. Although microenterprises are possible clients for their goods and services, whether credits, raw materials, or semi-finished goods, neither the banks nor other businesses have realized the potential for investment in microenterprises which involves a low level of risk. Perhaps this is more striking in Ecuador where, according to one person interviewed, entrepreneurs are less altruistic; it is a "typical sociocultural problem of ours."

## **RELATIONS BETWEEN THE GOVERNMENT AND PRIVATE PROGRAMS**

Even though the available statistical information is limited, it is helpful to summarize the investments made in the informal sector by the government and the more active private organizations. The private organizations, not including the Bank of the Pacific, have loaned much more than one million dollars to the informal sector since 1988. The government has worked with these same organizations to provide training and advisory services through agreements between UNEPROM and the NGOs worth \$323,420. In addition, the government has opened credit lines worth \$480,000 for microentrepreneurs in the banking system, although the level of disbursement of those funds has yet to be determined. The state's investment also includes the creation and initiation of CONAUPE, which will entail allocation of additional funds.

CONAUPE, which has yet to begin its operations, has stirred great interest among the private organizations. Other organizations are curious about what path this new program will take, what services it will offer, and whether it will place priority on credit or training.

The relationships between the private programs and UNEPROM date back more than three years, and have gone through two distinct stages. In the first period, from its inception in April 1986 until August 1988, UNEPROM inaugurated, organized, and made its initial contacts with private programs. These activities created much expectation on the part of the NGOs, which hoped to initiate numerous activities with the credit and technical assistance support offered by UNEPROM. When it turned out that such assistance was not forthcoming, there was immense disappointment on the part of the NGOs which soon gave way to skepticism.

Finally, the NGO programs agreed to work with UNEPROM to train microentrepreneurs. Limited by a lack of resources, UNEPROM was unable to carry out the other programs it had offered. Uncertainty and distrust prevailed, although people were aware of UNEPROM's difficult financial situation.

Since August 1988, under the new government, UNEPROM has redefined its goals and objectives, limited its agreements with NGOs to training programs, and finally signed credit

agreements with private banks. With the rules more clearly defined and the program more realistic, the relationship between UNEPROM and the NGOs is clearer and more direct. Even so, UNEPROM's unsteady beginning caused confusion and tensions in its relations with other entities which have not completely subsided.

### **Positive and Negative Factors in the Relationship**

In the view of those interviewed, there are several factors that limit and reduce the effectiveness of support for the informal sector. The first is the lack of clarity in government plans for working with microentrepreneurs. The fact that there are two programs indicates a duplication or overlap of efforts, rather than optimal use of resources.

The government has not clearly defined or articulated the role it expects the NGOs to play, even though the two government programs incorporate NGOs into their operations. Are the NGOs supposed to merely implement government plans? Or do they have a more autonomous and dynamic role to play in developing these microenterprise programs? What are the priority areas in which NGO cooperation is expected: training, technical assistance, or credit? These doubts have given rise to tensions and sometimes conflict between the government program and the NGOs.

The role of private business and the financial sector has not been clearly spelled out. What is the role of the private banks? What is expected of private businesses? Might they be able to take on the task of training the microentrepreneurs? Without a clear government policy, the private sector has not assumed any responsibility for working with the informal sector.

The sluggish government bureaucracy and seemingly endless red tape has been another factor preventing effective cooperation between the public and private sectors. In its first years, UNEPROM exhibited these characteristics and, as a result, a situation was created in which the government will have to earn the respect of NGOs in order to collaborate with them.

In turn, the private entities, according to one interviewee, have approached UNEPROM not only seeking technical and financial support for microenterprises, but also with hidden

agendas. At times they seek to meet objectives pertaining to their own individual or institutional development, which may be legitimate, but which may cast doubt on their motives and genuine desire to serve microentrepreneurs first and foremost.

In other cases, and due to the proliferation of foundations and agencies working with the microenterprise sector, some NGOs have not been appropriately trained to carry out a microenterprise project. For them, initiating such projects has been somewhat hazardous, and they have learned from their experiences with the first microentrepreneurs, who have sought out their assistance without receiving good service.

Despite the obstacles, there are some key factors that have fostered progress in NGO-government relations. One has been the enthusiasm, dedication, and mystique with which both public officials and private organizations have dedicated themselves to this task. They have been convinced of the importance of microenterprise programs and their potential for success, despite differences in conception and approach. The UNEPROM staff and the staff of the NGOs have also shared an interest in seeking solutions to the problems of microenterprises and to the marginalization and informal status to which thousands of Ecuadorians have been relegated.

Another positive impact has been the publicity for the microenterprise sector that UNEPROM has generated. Support for microenterprises has been portrayed in the media as a valid response to alleviate the critical conditions in which entrepreneurs of the marginal zones live and work. This effort to inform the public has raised interest in microenterprises and possible solutions to the socioeconomic problems faced by this key sector of Ecuadorian society.

The research that has been undertaken on the informal sector has helped to promote good relations between the government and the non-governmental organizations. The studies, sponsored by UNEPROM, have threshed out some basic concepts that underlie the microenterprise programs. This effort, sometimes made in conjunction with others, has strengthened government-NGO relations. It has also laid a solid foundation for working relationships based on shared knowledge and similar viewpoints regarding the issues of the informal sector, marginality, and the microenterprise world.

### **Suggestions for Improving Relations**

The first suggestion is to define and disseminate the government plans and programs for the informal sector. The inhabitants of marginal areas and those who are part of the informal sector should be informed; they have a right to know what plans have been formulated to address their needs, and how the government intends to implement them. Also, the government and private agencies participating or interested in participating in microenterprise programs must be aware of the government's plans.

Moreover, people from the informal sector and non-governmental organizations should be invited to participate in formulating the government's microenterprise program. By involving the various sectors and sharing the program's development, they will learn the rationale on which the programs are based, including its philosophy, methodology, and goals. When the program is implemented, both microentrepreneurs and private agencies will be convinced of the program's advantages and the potential problems they will have to face.

An open discussion including microentrepreneurs, government, and private entities would lead to a clear understanding of what each is trying to accomplish, and would help clear up doubts, uncertainties, and misunderstandings. On this basis, it would be possible to win the cooperation of each sector and eliminate opposition to and doubts about government intentions.

A nationwide information system should be established with a data base on the progress of each microenterprise program. The data base could include a variety of information, such as the entities involved in implementing programs, their methodologies, their level of coverage, and indicators of their efficiency and impact. This information would enable the government and the private entities to direct their actions and to correct and change direction in a timely fashion.

It would be advisable for both the government and the private agencies to train and prepare people for work in microenterprise programs. Those who train microentrepreneurs need training, as do the personnel who administer programs and the advisers who work directly with the microentrepreneurs. This entire

team requires more than technical training; the mystique necessary for working with the marginal population and members of the informal sector should also be conveyed to them. Without this attitude, their activity will be sterile.

Finally, the various parties involved in this process should work in the area in which they are most competent, or where their comparative advantage is most evident. The banking sector, for example, could be responsible for managing credit, while the private agencies could be in charge of training, technical assistance, and follow-up. The government should address the substantive and structural changes in rules, laws, and procedures that hinder the advance of microenterprise projects. The government should also take on the challenge of finding solutions to national economic problems that affect the microenterprise sector as well, such as inflation and availability of inputs.

Based on this criteria, the government's role is to serve as a catalyst and coordinator of actions carried out to benefit microentrepreneurs. The NGOs, in contrast, have developed their methodologies and shown that they are able to work directly with the sector. However, their coverage is limited by their access to funds. Therefore, the government should seek to capitalize on the NGOs' experiences, make known their results, and establish procedures and funding that enable them to meet the specific needs of microentrepreneurs. With well-defined lines of action, clear rules, and a non-interventionist approach that builds on the strengths of the private and public sectors, programs that effectively promote the economic development of the informal sector can be implemented.



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## GUATEMALA

### A THRIVING UNDERTAKING: PRIVATE AND PUBLIC PROGRAMS SERVING THE INFORMAL SECTOR

Elsbeth Revere

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#### INTRODUCTION

The urban informal sector of the Guatemalan economy experienced rapid growth during the economic crisis of the early 1980s. In 1986, when this crisis abated, estimates of the number of microenterprises in the metropolitan area of Guatemala City ranged from 45,000 to 125,515. The economic policy of the Cerezo government concentrated on this sector because of its potential to strengthen the economy, create employment, and increase the incomes of the poorest of the urban poor. The Government of Guatemala adopted a policy of providing direct aid to microentrepreneurs through credit, training, and technical assistance. The centerpiece of the government's informal sector policy is the Urban Microenterprise Multiplier System, known by the Spanish acronym, SIMME (*Sistema Multiplicador de Microempresa Urbana*).

In addition to SIMME, there are about a dozen private, non-profit programs serving Guatemala's urban informal sector. All are relatively new and growing rapidly. The private programs vary widely in magnitude, style, experience, and impact. In the best of cases, they combine high volume and operational efficiency with the mystique of the non-profit sector.

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This essay describes the experience of SIMME to date, and that of the most prominent private programs providing credit, training, and technical assistance to the urban microentrepreneurs of Guatemala. The information is drawn from reports and evaluations, and from a series of eleven interviews with administrators of public and private programs, their donors, and informed observers.

### **GOVERNMENT SUPPORT FOR MICROENTREPRENEURS**

The Government of Guatemala has two main programs that serve the informal sector, SIMME and IFDI, the Program of Financial Intermediation for Comprehensive Development (*Programa de Intermediación Financiera para el Desarrollo Integral*); both were established in 1988. IFDI strengthens local economies in rural areas by promoting the formation of producers' associations whose members benefit from large-scale purchases and sales. As IFDI is a rural program, and this study is an effort to analyze government initiatives for the urban informal sector, the paper focuses on the SIMME program.

#### **Urban Microenterprise Multiplier System (SIMME)**

SIMME has provided loans and training to urban microentrepreneurs since February 1988. The program represents an unusual collaborative effort among private organizations, government agencies, local banks, and international financial institutions. With strong and visible direction from the vice president of Guatemala, the program was designed to be large-scale and implemented quickly in order to have a substantial impact on informal sector microenterprises.

SIMME's objective is to generate massive employment opportunities in the informal sector and, as such, address three specific challenges: 1) to broaden economic opportunities for microenterprises; 2) to increase production in the sector and expand markets; and, 3) to develop a new economic strategy that responds to the needs of the population.

SIMME's original goals were extremely ambitious, such as assisting 40,000 microenterprises in the first three years. The microenterprises were to receive credit, training, and individual technical and marketing assistance. Based on the program's initial experiences, the target was reduced to 25,000

entrepreneurs in the first three years, with the goal of generating 75,000 jobs.

### **Structure and Operation**

SIMME falls under the direction of the National Commission for the Development of Microenterprise and Small Business, which is presided over by the vice president of Guatemala. The program is coordinated by the Technical Bureau, located in the office of the vice president. Funding comes from the Government of Guatemala and international donors, including the Agency for International Development (USAID), and the governments of Taiwan and Belgium. Total investment to date is \$10.3 million. In addition, the United Nations Development Programme (UNDP) and the Inter-American Development Bank (IDB) have provided extensive technical assistance.

SIMME provides credit, training, and technical assistance to microenterprises that are located in urban areas and have: fewer than eight employees (including the owner); little division of labor; assets that are not in excess of \$5,555; a track record of at least 18 months; and little or no access to regular credit sources. They must be involved in production, manufacturing, or services and use simple production techniques.

The loans are for equipment, working capital, and raw materials. The average loan is \$1,300 for 36 months, with an annual interest rate of 16%. There is an application fee of \$25. Attendance is required at four pre-loan training sessions and additional training is available.

The program was designed to work through non-governmental organizations (NGOs) and draw on their informal sector experience to promote the program, find borrowers, complete loan documents, and provide follow-up technical assistance. Six NGOs joined SIMME at the outset of the program but only two of the six had prior experience with the informal sector. Initially, the more experienced NGOs were reluctant to participate. At a later stage, nine more NGOs joined. Each of the 15 private organizations working with the program is assigned a specific geographical area.

Three banks, one governmental and one semi-governmental, process and approve the loan applications and manage the

program funds. The *Banco de los Trabajadores* (BANTRAB) was the first bank to participate. Two more institutions, the *Banco de Desarrollo* (BANDESA) and *Crédito Hipotecario Nacional*, joined in the second phase of the program. In contrast to BANTRAB, the latter banks have branches nationwide.

Two organizations, one public and one private, train the SIMME staff and the microentrepreneurs. The Technical Training Institute (*INTECAP Instituto Técnico de Capacitación*) is a public entity enlisted to train advisers and to provide business management and technical training to microentrepreneurs. More recently, a private organization known as FADES has been training microentrepreneurs. Some of the NGOs are also increasing their own training programs.

### Achievements and Impact

SIMME reports the following achievements from February 1988 to August 1989:

Number of loans disbursed:	5,552
Microentrepreneurs financed:	5,072
Total amount lent: (US\$)	7,560,521
Average loan amount: (US\$)	1,362
Estimated number of jobs created: (1.25 per microentrepreneur financed)	6,340
Indirect beneficiaries: (Family members of direct beneficiary and an average of 4 employees)	106,512
Total beneficiaries:	117,924
Cost per dollar lent in 1988:	.14
Funds recovered: (as of June 1989)	1,070,000
Funds recovered (%)	18%

The program expanded beyond the metropolitan area of Guatemala City to nine other urban areas of the country. During the same period, the number of participating NGOs increased from six to fifteen and the number of participating banks rose from one to three. In addition, 17 courses and workshops have been held to train the NGO and bank personnel. Special courses have been offered for microentrepreneurs in various technical areas (e.g. maintenance of industrial machines, baking,

industrial sewing). Also, two microenterprise market fairs were held, enabling 820 microentrepreneurs to earn profits of more than \$740,000.

### **Strengths and Weaknesses of the SIMME Program**

In general, three criticisms emerge from the Guatemalan Government's decision to concentrate all of its resources for the informal sector in the SIMME program.

- The resources could be used more productively if they were channeled through the most efficient private organizations, freeing them to use their own methodologies. Presently, the NGOs that work with SIMME must adopt the SIMME package of pre-credit training sessions, client selection criteria, loan sizes, loan periods, and interest rates, which may not coincide with the operational strategy that NGOs find to be efficient or successful.
- The government appears to have concentrated excessive resources in a sector highly vulnerable to competition and economic change. Some observers suggest that the program's economic impact and resources might disappear in a period of high inflation or other economic turmoil. In addition, due to a high level of competition within the sector, critics question whether one microentrepreneur might be helped at the expense of another.
- Intensive government involvement in the SIMME program has meant that little attention is paid to changing laws and public policies which discriminate against the informal sector. The government is neglecting the legislative and regulatory sphere, an essential component of comprehensive policy, as well as the source of many informal sector disadvantages.

The assessment of the specific strengths and weaknesses of the first year of the SIMME program by individuals within and outside the government is strikingly consistent. Some of the deficiencies cited below can be attributed to inexperience. Many of them have already been recognized and corrected by SIMME.

### **Strengths of SIMME**

The SIMME program has sound objectives and ambitious goals. The program is designed to work nationwide and was expanded in its second year to include most urban areas of Guatemala. While the original target of 40,000 microentrepreneurs reached in the first three years was decreased to 25,000, the program still seeks to reach a large number of beneficiaries in a very short time.

The program is directed by the vice president of the Republic. The strong political support that the program received from the vice president's leadership has been advantageous for several reasons:

- The government saw SIMME as a priority and the program was launched very quickly;
- The vice president's close association with SIMME provided visibility for the informal sector and signaled a commitment to integrate microenterprises into the economic mainstream;
- The international donor community eagerly supported the program, giving it access to resources that are only available through government-to-government contracts.

The decision to work through NGOs, instead of creating a new ministry recognized the important role of NGOs in providing services to the informal sector, and may result in the formation of new NGOs.

The inclusion of research funds to study the microenterprise sector in the program budget demonstrates a broad interest that goes beyond politics and indicates a relatively long-term commitment to the development of the sector.

### **Weaknesses of SIMME**

The program's original goals, which were modified, were lofty and unattainable. They led to initial expectations which the program could not meet. Furthermore, the goals were based entirely on the amount and number of loans disbursed, rather than on an efficient rotation of the portfolio or financial self-sufficiency. Standards for portfolio quality, such as acceptable

arrears and default rates, were not defined. Through the course of the program, factors related to the quality of the portfolio have been one of the main problems.

The design of some of the project's financial policies have had a negative impact on the program's financial situation.

- Due to inexperience, some inappropriate policies were formulated. For example, a lengthy grace period was permitted which contributed to high default rates. This policy has since been changed.
- The average loan term is 36 months and, consequently, the rotation of capital is very low. Occasionally, there have been periods during which no funds were available to make new loans.
- The interest rate is too low to cover the administrative costs, meaning that the program will always have to depend on subsidies or donations.
- The *Banco de los Trabajadores* (BANTRAB) does not understand microentrepreneurs, lacks flexibility, and does not have branches, thus making it difficult for the borrowers to make their payments. However, the two banks that recently joined the program do have an extensive network of branches

The design of training and technical assistance for the microentrepreneurs was inadequate. INTECAP did not have experience with microenterprises when the program began. In addition, SIMME's training program is optional and its advisers, because of pressure to disburse high numbers of loans, have very little time for technical assistance and follow-up. Consequently, some clients receive no substantive training or technical assistance and have little contact with the program once they receive their loan.

From the outset there has been a lack of understanding between the NGOs and SIMME.

- The NGOs with prior work experience in the informal sector did not participate in the program because they were not involved in its design. They feared that they would lose their autonomy if they participated.

- Some organizations were worried that "phantom" NGOs might be established that would give all NGOs a bad image, especially if the program were to fail.
- There is concern among the non-participating NGOs that the SIMME program is beginning to compete with them, not only for clients but also for staff, especially outside of Guatemala City.
- The NGOs that participate in the program are pressured to meet quantitative goals but are given very little support for institutional development.

The program began with a poor monitoring and evaluation system that does not provide information regarding the impact of the loans on the socioeconomic situation of the clients. Similarly, this system does not supply the information required to efficiently manage each NGO's line of credit. The lack of adequate monitoring systems may have contributed to high default rates.

The project's top-level management is strong, under the sound direction of the Technical Bureau, but mid-level management is weak. Some participating NGOs have autocratic management systems which do not allow for a fluid exchange of information among the program staff. In addition, communication between SIMME, NGOs, and BANTRAB is poor, with each entity feeling somewhat disconnected from the overall project.

Finally, the visible leadership of the vice president prompts most people to believe that the program has a political goal as well as an economic one. There is some concern that clients may not feel obligated to repay their loans, especially if the government changes after the next election. There is also concern that the program will not be continued after the next election.

### **PRIVATE SECTOR SUPPORT FOR MICROENTERPRISES**

Like the government, the private sector programs for the informal sector have concentrated on credit, training, and technical assistance for microentrepreneurs. There are 20 to 25 programs serving microenterprises and small businesses in rural and urban areas of Guatemala. Many of these are new, or



very small, organizations or programs. As a result, it is difficult to count them and impossible to assess their achievements and impact. Nonetheless, about a dozen organizations have sufficient experience and visibility to merit mention here. Of these programs, the two that receive technical support from ACCION International/AITEC (*Génesis Empresarial and PROSEM*) are generally considered the most successful.

### **Génesis Empresarial and PROSEM**

Entrepreneurial Genesis (*Génesis Empresarial*) is a program of the Technology Foundation (FUNTEC: *Fundación Tecnológica*) which provides credit, training, and technical assistance to microentrepreneurs in Guatemala City and three regional centers. The Genesis program makes loans to individuals and groups that work in production, services, and marketing. It also offers pre-credit orientation sessions and training during the loan period.

Entrepreneurial Promotion and Services (*PROSEM: Promoción y Servicios Empresariales*) is a program of the Foundation for the Development of Socioeconomic Programs (*FUNDAP: Fundación para el Desarrollo de Programas Socio-económicos*) which operates in Guatemala's second-largest city, Quetzaltenango, and three other regional centers. The program's design is nearly identical to that of Genesis, offering loans and training services to groups and individuals. Both programs are affiliated with ACCION, and both use the solidarity group methodology characteristic of the ACCION programs.

The following table shows some of the achievements and indicators of the two programs in their first 13 months of operation (July 1988 to August 1989):

**TABLE ONE**  
**GENESIS AND PROSEM**

Indicator	Genesis	PROSEM
Number of loans:	1,388	1,446
Amount loaned: (US\$)	825,471	522,071
Average loan amount: (US\$)	595	361
Number of training sessions:	499	511
Total participants trained:	3,498	1,922
Percentage of capital recovered:	74%	60%
Rate of arrears:	6.8%	2.3%
Cost per dollar lent:	.04	.02
Operational self-sufficiency:	44.6%	86.7%

### **Other Private Sector Programs**

In addition to PROSEM and Genesis, there are many other private programs that provide credit, training, and technical assistance to microentrepreneurs. The Foundation for the Development of Women (*FDM: Fundación para el Desarrollo de la Mujer*) was established in 1981, and works with women who own businesses in Guatemala City and several other cities. The Foundation to Assist Small Business (*FAPE: Fundación de Asistencia para la Pequeña Empresa*) is a religious NGO that works with SIMME, but also continues its own microenterprise loan program, begun in 1985. The Foundation for the Development of Small Business (*FUNDESPE: Fundación para el Desarrollo de la Pequeña Empresa*) is a new program that offers credit and technical assistance in Quetzaltenango. The Association for the Home and Development (*HODE: Asociación del Hogar y Desarrollo*) began a microenterprise loan program in the Guatemala City metropolitan area. *Plan Internacional* makes loans of \$20 to \$550 to subsistence-level entrepreneurs in Guatemala City and three other cities.

Though the following table is limited, it shows some available results from the above-mentioned organizations.

**TABLE TWO**  
**SUMMARY OF FIVE PROGRAMS**

INDICATOR	FDM 1981-1989	FAPE FUNDESPE 1985-1987	FUNDESPE 1 YEAR	HODE 1988	PLAN
Number of loans.	202	155	23	150	194
Total amount: (US\$)	41,844	250,759	43,636	60,200	n.i.
Average loan: (US\$)	1,200	n.i.	n.i.	n.i.	185
Microentrepreneurs benefited:	600	n.i.	n.i.	n.i.	n.i.
Families benefited:	1,300	n.i.	n.i.	n.i.	n.i.
Employment generated:	n.i.	n.i.	25	250	n.i.

There are other organizations engaged in activities directed towards the informal sector. These include the Guatemala Finance Fund-Export Bank (**FIGSA-BANEX: Fondo Financiero Guatemala-Banco de Exportación, S.A.**) which established a loan fund of \$185,000 for microentrepreneurs. This program grew out of the experience of Genesis and grants automatic loan approval to borrowers with a good credit record with Genesis. The Association of Development and Service Organizations (**ASINDES: Asociación de Entidades de Desarrollo y de Servicio**) is an intermediary organization which channels an AID grant to member NGOs to support their microenterprise programs. Nine organizations have received from \$11,000 to \$44,500 through this program. The Peace Corps is expanding its small business program and will have volunteers working as promoters with the Women's Foundation (**Fundación para la Mujer**) offering technical assistance to entrepreneurs.

In addition, there are several organizations working with rural microenterprises, such as CARE, the Penny Foundation (**Fundación del Centavo**), the Cultural Affairs Institute

*(Instituto de Asuntos Culturales)*, REDH Integral, and the Guatemalan Movement for Rural Reconstruction (*Movimiento Guatemalteco de Reconstrucción Rural*).

### **Strengths and Weaknesses of the Private Programs**

Based on the foregoing summary, it is apparent that Genesis and PROSEM are the only private programs operating on a scale which may enable them to have a major impact on the informal sector. In addition, the lack of comparable information on the achievements of private programs suggests the need for a detailed study of costs and benefits especially in terms of generating employment of the varied programs currently serving the microenterprise sector of Guatemala.

Some private programs place a high priority on operational efficiency and financial self-sufficiency. Others are more welfare-oriented, emphasizing extensive assistance to each client. Noting that not all of the private programs are alike, observers of informal sector programs made the following generalizations.

#### **Strengths of Private Programs**

Private programs, in contrast to government programs, are not bureaucratic and have a strong commitment, indeed a mystique to serve the sector. Some have successfully identified the sector's needs, and are able and willing to work in the most underprivileged areas. In addition, the programs that have emphasized efficiency are achieving high levels of financial self-sufficiency and rotation of their portfolios. Some are growing very quickly and becoming secure and independent.

Another important achievement is that the private programs have forged ties with the business sector. By drawing representatives of industry and commerce to their organizations and boards, and by establishing contacts with banks, the programs are spreading awareness of the informal sector to all levels of Guatemalan society.

#### **Weaknesses of Private Programs**

The most common weakness of the private programs is their small size and lack of experience. On the whole, these programs demonstrate an ability to address the needs of only a small

percentage of the enormous informal sector. Moreover, they are not able to attract sufficient resources to significantly increase their scale of operations.

From a programmatic standpoint, some organizations are not geared towards self-sufficiency: they are inefficient, have high administrative costs, and charge very low interest on their loans. In other words, their orientation is paternalistic rather than entrepreneurial. Some are institutionally weak, and do not receive sufficient support from their directors.

Finally, some critics of the private programs argue that they place too much emphasis on training and do not pay enough attention to credit. The critics suggest that training and technical assistance should continue even after the loan has been repaid.

## **RELATIONS BETWEEN THE PUBLIC AND PRIVATE PROGRAMS**

Historically, relations between the NGOs and the Government of Guatemala have been difficult. Formal relations barely exist except in the case of the NGOs that work with SIMME. Informal exchanges between the staff of private and public organizations do exist, however, and are generally characterized as cordial or friendly, but distant. This attitude is explained in part by the relative youth of microenterprise programs in Guatemala—only a few have been working with microentrepreneurs for more than three years. As a result, many of the NGOs are in the process of building or expanding their programs and have little time for coordination or outside collaborative activities.

Some observers claim that certain NGOs were somewhat close-minded in deciding not to participate in the SIMME program. While greater collaboration with government entities is difficult, the effort is important, especially as the government has become more concerned with the informal sector. There is now an opening for improved communication and trust between the two sectors; this can only happen through formal relations.

### **Factors Working Against Improved Relations**

The managers of private sector programs are quick to distinguish between coordination and collaboration when

discussing their relations with the government. While some would like to increase coordination between the two sectors, few wish to enter into a formal collaborative relationship with SIMME or the government. This attitude is due, in part, to the following factors:

- o The SIMME program was designed to incorporate NGOs, but does not allow them to use their own methodologies. Since participating in SIMME has meant, in some cases, setting aside a successful methodology in exchange for an untested one, many of the NGOs decided not to participate. Some even maintained the greatest possible distance, fearing that the program would fail, taking with it other programs that serve the sector.
- o This is a time of growth and expansion for many of the private programs. They feel that they do not have enough time for activities involving coordination with others, especially with the time-consuming government bureaucracy. Some argue that this is an important long-term investment for helping the government change and improve its work in the informal sector. Nevertheless, the benefits will not be seen until far into the future, and the current efforts seem to yield very little for the private organizations.
- o If both SIMME and the private programs continue to expand, there may be competition for financing, clients, and staff. SIMME already pays its promoters more than the other programs, making it difficult for the private programs to find qualified personnel.

The lack of communication between the private and public programs contributes to misconceptions of one another's activities, which is sometimes harmful to relations. SIMME, for example, has corrected some of its original design problems, but the administrators of other programs believe that it continues to commit the same errors. Such false impressions may tarnish the image of a program and even lead to mistaken criticisms.

The government's failure to support the private programs with funds, services, or training is another disincentive to coordination and collaboration. While there is an office in the Ministry of Finance to support NGOs, those NGOs that work with microenterprises have not found it to be helpful.

- Finally, the political nature of SIMME is a concern for many potential collaborators. Since it is so closely identified with the vice president, SIMME might not receive the support it needs to continue after a change of government. It also lacks the professional image of the private sector, an image which encourages microentrepreneurs to repay their loans.

### **Factors Favoring Improved Relations**

Most observers cite personal relationships as the single most important factor supporting collaboration. With time, as the organizations get to know one another better, they are expected to improve their relations and coordinate their actions more effectively.

Among the initiatives for strengthening relations between the public and private programs are the regular lunch meetings that began with an informal group made up of representatives from ACCION, AID, FDM, the Peace Corps, and ASINDES. The group has become quite large, with a list of 49 participants. They had some six or eight successful meetings, but the last two were poorly attended because people had begun to lose interest. At present, the programs assisted by ACCION and SIMME are establishing a system of coordination.

### **Recommendations for Improving Relations**

All the people interviewed for this study agreed that it is possible to improve relations among the participants of informal sector microenterprise programs. Most pointed to the lunch meetings as a positive first step, and many made the following suggestions:

- Seek funds for one agency (possibly ASINDES) to coordinate substantive meetings of the private and public organizations that work with the informal sector. At these meetings specific technical issues of mutual interest would be discussed, such as training methodologies or informal sector marketing problems.

Hold planning seminars and training sessions on topics of interest to the microenterprise programs; carry out joint field trips to visit and discuss projects.

- Work collectively to reform the laws to be more responsive to the needs of microentrepreneurs and the informal sector;

develop and implement a joint strategy to involve and educate commercial banks about the needs and potential of this sector.

- o Share information on each program, including needs, achievements, and changes, so that areas of unmet needs are identified and programs may complement rather than compete with each other.
- o Establish a committee comprised of the National Commission for the Development of Microenterprise and Small Business (which has overall responsibility for managing SIMME), representatives of NGOs, microentrepreneurs, larger businesses, and banks, to provide advisory services on policy and program issues.
- o Continue long-term efforts to foster trust and enhance relationships between the NGOs and the government, including strategies that allow the NGOs to demonstrate their effectiveness to the government, and that give the government a chance to show that it can support private organizations without restricting their autonomy.

## **CONCLUSIONS AND OUTLOOK**

The programs providing credit and training to microenterprises in Guatemala, both public and private, are relatively new and are experiencing rapid growth. At this time, it would be hasty to judge how the relationships between them will develop, but it is possible to determine that a strict private-public dichotomy does not correspond to the Guatemalan experience.

Close observers of microenterprise programs in Guatemala are quick to point out that there are vast differences among the private programs. While some are just getting off the ground, others have several years' experience; some use an approach based on individual assistance, and others emphasize efficiency and self-sufficiency. Furthermore, while some are very small and prefer to remain small, others are already lending substantial sums and are growing rapidly.

The SIMME program is also difficult to categorize. In contrast to other governmental efforts, SIMME, to a large extent, is based on private organizations and financial intermediaries. In



contrast to most government initiatives, it has a stated commitment to large-scale impact on the informal sector.

As the support system servicing microenterprises grows, its public and private sector participants recognize the need for communication and the benefits of coordination among themselves. There is a clear desire to build bridges through meetings and informal relationships, rather than aligning in different groups. Guatemala appears to have an opening for dialogue and improvement in NGO-government relations.

As the Guatemalan microenterprise sector continues to grow, there will be opportunities for private sector programs to gain more experience and expand their programs. As a result, SIMME will be strengthened by the increased prowess of participating NGOs. As this relationship solidifies, the organizations working with microenterprises will increase and improve communication among themselves. This would truly make support for the informal sector in Guatemala a thriving undertaking.

**APPENDIX I**

**ACRONYMS**

**ACCION/AITEC** Acción Internacional Técnica/ACCION International

**ASINDES** Asociación de Entidades de Desarrollo y de Servicio/ Association of Development and Service Organizations

**BANDESA** Banco de Desarrollo/Development Bank

**BANTRAB** Banco de los Trabajadores/Worker's Bank

**FAPE** Fundación de Asistencia para la Pequeña Empresa/ Foundation to Assist Small Enterprise

**FDM** Fundación para el Desarrollo de la Mujer/Foundation for the Development of Women

**FIGSA-BANEX** Fondo Financiero Guatemala-Banco de Exportación/ Financial Fund of Guatemala - Export Bank

**FUNDAP** Fundación para el Desarrollo de Programas Socio-económicos/Foundation for the Development of Socioeconomic Programs

**FUNDESEPE** Fundación para el Desarrollo de la Pequeña Empresa/ Foundation for the Development of Small Business

**FUNTEC** Fundación Tecnológica/Technological Foundation

**HODE** Asociación del Hogar y Desarrollo/Association for the Home and Development

**INTECAP** Instituto Técnica de Capacitación/Technical Training Institute

**NGO** Non-governmental organization

**SIMME** Sistema Multiplicador de Microempresa Urbana/ Urban Microenterprise Multiplier System

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**APENDIX II**

**LIST OF NGOS PARTICIPATING IN THE SIMME PROGRAM**

**ORIGINAL PARTICIPANTS** (All work in Guatemala City)

ADESCO: Asociación para el Desarrollo Comunitario

FAPE: Fundación de Asistencia para la Pequeña Empresa

FUNDAGUATEMALA: Fundación Guatemala

FUNDEMIX: Fundación de Desarrollo de Mixco

FUNDESEM: Fundación de Desarrollo Empresarial

MICROS: Fundación para el Desarrollo de la Microempresa

**NEW PARTICIPANTS**

DESALT: Desarrollo Alternativa (Quetzaltenango)

ASODESPT: Asociación Desarrollo para Todos (Zacapa, Gualan, Chiquimula)

FUNDAGUATEMALA: Fundación Guatemala (Totonicapan)

ADEPH: (San Marcos)

AYUDENSE Y NOSOTROS AYUDAREMOS (Sololá)

FE Y ALEGRIA (Mazatenango and outskirts of Guatemala City)

ASOCIACION ESTUDIO AREAS MARGINALES (Villa Nueva)

DEFAMCO (Amatitlán)

## MEXICO

### DEVELOPING THE MICROENTERPRISE SECTOR: PUBLIC AND PRIVATE INITIATIVES

Mario Alberto Diaz

Mario Alberto Diaz received his Masters in Economics from the University of California, Santa Barbara, with a specialty in urban and regional economics. He has carried out several research projects on economic issues in Mexico and was Director of the Economics Research Division of the Alfa Industrial Group. Recently, he has been teaching economics at the Technological Institute of Monterrey.

#### INTRODUCTION

Microenterprises in Mexico, without a doubt, are becoming an important instrument for mitigating the crisis of unemployment and growth affecting the national economy. The advantages of microenterprises as a source of employment and as a way of establishing enterprises with low levels of investment make them attractive in the eyes of both the public and private sectors. Microindustry is the only sub-sector of industry that maintained constant growth over the last three years; there were no major changes in the number of small and medium-sized enterprises<sup>1</sup>. Although growth of the microenterprise sector in Mexico has been more dynamic than other strata of industry, it is clear that such growth could occur at an even faster pace if there were a joint strategy and a shared objective on the part of the private sector and the government.

This study reviews the support provided by the public and private sectors to the microenterprise sector, drawing on available information. It also analyzes the shortcomings in support for the sector, citing the results of a questionnaire

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1. SECOFI, Dirección General de Industria Mediana y Pequeña, "Industria Mediana y Pequeña", No. 29, Dec. 1988, Mexico City.

directed to 12 experts involved with the microenterprise sector. In conclusion, some strategies are proposed to improve cooperation between the public and private sectors to benefit microenterprises.

### **GOVERNMENT PROGRAMS TO SUPPORT MICROENTERPRISES**

Historically, Mexican industrial policy has been geared to fostering the development of medium and small industry. It was not until 1988 that the government included microindustry in its development policy, with the Federal Law for the Development of Microindustry. The fundamental objective of this legislation is to promote investment in new microindustries and to strengthen existing ones through provisions which: simplify their establishment and operation; make it possible for them to carry out their legal paperwork locally; and promote their development by granting tax, financial, and marketing support and facilities, as well as technical assistance<sup>2</sup>. The spirit of the law is to support growth and regional development by simplifying administrative processes, making it easier to form microindustries. A microindustry is considered to be an establishment with less than 15 employees and annual sales of less than 300 million pesos (\$114,000)<sup>3</sup>, an amount that fluctuates with inflation.

Basically, there have been four specific government initiatives to support microindustries.

- The Specialized Window: As part of the Federal Law for the Development of Microindustry, the Specialized Window was established. It is an administrative streamlining measure that makes it possible for a microentrepreneur in industry to fill out a specialized form for a license which immediately enables him or her to become legally established and commence operations.
- The State Funds for Industrial Development: The State Funds were the first entities to formally support

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2. SECOFI, Dirección General de Comunicación Social, "LA LEY FEDERAL DE FOMENTO A LA MICROINDUSTRIA", Mexico City, 1988.

3. The exchange rate used to convert all Mexican peso amounts to dollars is the average controlled rate for each year (January to September for 1989). All amounts in this document are shown in dollars.

microindustry. Each state has a public development agency which, with public monies channeled through *Nacional Financiera*, the federal government's development bank, provides credit to microindustries.

- Program for Integral Support to Informal Microindustry (*PROMICRO: Programa de Apoyo Integral a la Microindustria Informal*): In 1987, *Nacional Financiera* implemented this program, which provides credit to public and private sector development agencies that meet their requirements. In addition to providing credit, PROMICRO supports the entities through quotas paid per advisory visit and per hour of training imparted to microentrepreneurs.
- The Guarantee Fund for the Development of Medium and Small Industry (*FOGAIN: Fondo de Garantía y Fomento a la Industria Mediana y Pequeña*): Since 1985, *Nacional Financiera* has channeled credit, at preferential rates, to family production units through its Artisan Workshop program. The program works with the support of the development agencies.

The following is a description of these initiatives and the results they have produced.

### **The Specialized Window**

The incentives for microindustries to register under this system include:

- 20% income tax exemption for three years beginning with the date of registration in the Microindustry Register;
- a Tax Promotion Certificate that provides for a 40% tax deduction on total investment in installations, machinery, and equipment;
- facilities for standardization and simplification of bookkeeping;
- payment every two months of the necessary quotas to the National Institute of Housing Funds (*INFONAVIT: Instituto Nacional de Fondos para la Vivienda*), instead of monthly payments;

- o elimination of the licensing procedures for 43 industrial lines of business.

Even though 51 Specialized Windows are operating in all 31 States of Mexico, few microindustries have taken advantage of them to join the Microindustry Register. In a country with hundreds of thousands of microindustries, only a negligible percentage, perhaps 250 enterprises, have included themselves on the register. Administrative simplification through the Specialized Window has not worked. Apparently, the incentives are not sufficient to motivate enterprises to move from the informal to the formal economy, which is the ultimate objective. Although there are no direct expenditures associated with registering, registered entrepreneurs have to pay INFONAVIT income tax, and other costs not incurred by informal sector operators.

### **The Program of State Funds**

This program began its activities by guaranteeing bank financing to microindustries. At present its scope of action has been broadened to technical assistance and training programs, and to granting direct financial assistance. Also, in some states support has been given to risk capital, in conjunction with the new capital investment companies (*SINCAS: Sociedades de Inversión de Capital*).

Of Mexico's 31 states, 29 are participating in the program. As of late 1988, these state development funds had granted 3,538 guarantees for a total sum of \$7,815,900<sup>4</sup>. The most active state fund, known as FOMICRO, in 1988 was that of Nuevo León, with 845 loans for a total of \$1,450,000, or 18.5% of the total resources. In the rest of the country, with the exception of Jalisco, Chihuahua, and Tabasco, the activity of these State Funds was very limited.

In the particular case of Nuevo León, FOMICRO granted a total of \$3,456,777 in credits over a four-year period (August 1985 to July 1989). It supported 793 enterprises, generating 1,966 new jobs and maintaining 3,752 others, for an average of \$1,758 loaned per job created.

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4. NAFINSA, "El Mercado de Valores", No. 15, August 1, 1989, Nuevo León, 1989.

This amount loaned per job created, which is high compared to another private program (see Appendix I), is due to the credits being directed to "large" microenterprises with high sales volumes and large numbers of employees. That is, a fairly formalized, consolidated sector, with large investments, is being reached, resulting in a high cost per job created.

In addition, 81.5% of the guarantees in the state of Nuevo León were in the metropolitan area<sup>5</sup>, which means that one of the objectives of the program, decentralization of industry, is not being attained. Nonetheless, it should be noted that other municipalities located in priority areas, such as Sabinas, Hidalgo, and Linares, have received a considerable number of loans through FOMICRO.

There is no analysis of payments in arrears which, according to available information, are high.

### **Program for Integral Support to Informal Microindustry (PROMICRO)**

The purpose of the PROMICRO program is to help integrate informal-sector enterprises into the formal sector, so as to consolidate their development. Its objectives are: to promote efficient development of the sector to preserve the sources of employment; to assist microindustries in achieving economies of scale and reasonable levels of productivity through technical assistance and training; to facilitate access of microindustries to preferential credit; to promote articulation of the national productive apparatus by developing schemes for vertical and horizontal purchasing arrangements; and to enable operators of microindustries to overcome their informal status and become recipients of credit.

PROMICRO provides training courses, technical assistance, and follow-up support to these activities. It also supports microindustries through development agencies that are authorized to receive a line of credit for making loans to microindustries. The development entities are either trusts created by the state governments, educational institutions, or non-profit organizations that assume responsibility for the evaluation, approval, and recovery of the loans. They must

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5. Government of the State of Nuevo León, FOMICRO, Monterrey, Nuevo León, 1989.



deposit, as a guarantee, 10% of the sum they request from the PROMICRO line of credit.

From the outset of the program in 1987 until September 1989, 27 entities had received authorization for a line of credit from PROMICRO, with 21 currently disbursing funds from that credit line. In addition to the line of credit to the entities, *Nacional Financiera* covers the expenses that the entities incur for training and technical assistance for the program beneficiaries.

However, the eligibility requirements make it difficult for the development agencies to access the credit line<sup>6</sup>. The procedure for opening a credit line is highly bureaucratic, requiring that nine documents be filled out. Also, the entities have to operate in accordance with the recommendations of a manual with 22 chapters, which covers matters such as organizational structure, training for the microentrepreneurs, analysis of applications, technical assistance, and the PROMICRO information system.

Unfortunately, the quantitative information for discussing the level of disbursements and PROMICRO investment activities has not been accessible.

### **The Artisan Workshops Program**

FOGAIN disburses resources from the national government, the World Bank, and the Inter-American Development Bank. The resources channeled by FOGAIN through the Artisan Workshop program came to more than \$4.0 million in 1988<sup>7</sup>. The loans are for up to \$30,000 for three to six years. This large loan size gives the impression that the program is serving a larger and more stable population of enterprises than those generally considered to be "microenterprises."

In 1989, this program experienced a major boom, as disbursements increased 321.4%, considering only the January-July period. The private institutions, especially *Asesoría Dinámica a Microempresas*, known by its Spanish acronym

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6. See requirements in: SECOFI, Dirección General de Industria Mediana y Pequeña, "Industria Mediana y Pequeña", No. 26, September 1988, Mexico City.

7. FOGAIN, Dirección de Seguimiento de Crédito, Department of Statistics and Publications.

ADMIC, contributed to the program's success; this agency alone distributed \$698,000 to microindustries, accounting for 44% of the national total and 79% of the funds in Nuevo León.

The most active states in this program have been Jalisco and Nuevo León, which together absorbed 80% of the total program funds in 1988 and 1989. There is no doubt but that the most economically backward states have not benefited from the program, which is an indication that industrial decentralization is not being achieved.

### **Strengths and Weaknesses of Government Support**

An entire process has been visualized for providing state support to developing microindustries. Once the microindustrial entrepreneurs have completed the cycle of training, technical assistance, and credit with a development entity collaborating with PROMICRO, they may turn to the Artisan Workshops program, through which they receive financing and technical assistance. In a third stage, the entrepreneur may apply to the regular FOGAIN program, which is supposed to provide financing to microindustry, small industry, and medium industry. Finally, it is hoped that the microindustrial entrepreneur will be prepared to enter into a direct relationship with commercial banks.

However, these microenterprise promotion and support efforts by the public sector have not been very successful. There are several factors that explain the weaknesses. The national government has no overall strategy for the sector; little is earmarked for loans to microindustries; the loans granted have been large, from \$5,000 to \$30,000, and reach the largest and most stable microenterprises in the sector; only the most industrialized states have absorbed the credits, which has meant little decentralization of industry; and the jobs created have been at a high cost considering that the efforts are directed to the microindustry sector.

Moreover, the development entities lack financial support to cover their operating expenses for disbursing credit from PROMICRO or the Artisan Workshops lines of credit. The interest charged on the loans is set by *Nacional Financiera* and leaves practically no margin for the development entities. As a result, although government resources are being invested, no additional resources are available for operating expenses. This

factor may be limiting the level of disbursement as well as the number of development entities using these lines of credit.

Notwithstanding these weaknesses, the current administration has paid more attention and earmarked more resources to the microenterprise sector than previous administrations. The Artisan Workshops and PROMICRO programs were conceived of and implemented by the current administration. Their implementation is evidence of the government's concern for developing the microindustry sector.

The results of the questionnaire directed to people involved in work with the microenterprise sector show mixed opinions about the government's support. Less than half of those interviewed (42%) believe that there has been sufficient support for the sector. Some 75% of the interviewees qualified the government programs as good or fair, while 16% said they were bad. As for financial support, 75% agreed that it has been insufficient.

Many agreed that the Program of State Funds, loans at preferential rates, and administrative simplification are the strongest points of public sector support. On the other hand, half of those interviewed believe that administrative simplification has not worked. Interviewees who work in the financial sector all pointed to financing as the strongest point, while public sector representatives were the ones who mentioned administrative simplification.

The weak points most commonly mentioned were: errors in administrative simplification; an inadequate fiscal policy, since for tax purposes a microenterprise is treated under the same terms as a small business; and shortcomings in the law for bringing microentrepreneurs into the formal economy. Other aspects mentioned were: insufficient technical assistance in administration and production; lack of timeliness in the development fund credits; and persisting inaccessibility to credit for microenterprises.

### **PRIVATE PROGRAMS SUPPORTING MICROENTERPRISES**

The most successful private program offering comprehensive support to the sector is that of the institution **ADMIC: Asesoría Dinámica a Microempresas**, A.C. There are other lesser known programs such as the **Asociación de Desarrollo del Estado de**

**Chihuahua y DESEM: Desarrollo Empresarial Mexicano.** The first works with the maquiladoras, businesses that contract for piece work from larger businesses, and has obtained few results in microindustry. DESEM is the Junior Achievement program of Mexican universities, in which certain selected students set up a company, even selling and displaying their products. Other organizations that work in rural development, health, and other areas have components that support microenterprises, but ADMIC is the only one that works exclusively with microenterprises.

ADMIC is a private, non-profit institution founded in 1980 and affiliated with ACCION International/AITEC. It offers comprehensive support to microentrepreneurs, providing technical assistance, training, and credit. As of 1988, ADMIC operated with its own funds, donations, and loans from international institutions. In 1989, it began to disburse FOGAIN resources, leading to a substantial increase in its activities due to an increase in available credit funds. From January to July 1989, ADMIC distributed credits to microenterprises for \$698,000 from the FOGAIN Artisan Workshops program. This represents 44% of that program's total disbursements nationwide for that period.

ADMIC presently operates in six states (Nuevo León, Coahuila, Tamaulipas, Chihuahua, Querétaro, and Puebla) and the Federal District. It focuses its efforts on family businesses that have never received credit. Its loans are small: the first loan to an entrepreneur is generally for less than \$600, and the following ones may reach \$7,000. The larger loans are with FOGAIN funds channeled through the **Banco Mercantil del Norte** (BANORTE). The small initial loans have made it possible for entrepreneurs who do not receive credit from other development agencies to receive ADMIC support and have also contributed to a strong and expanding program.

To date, ADMIC has disbursed more than 4,700 credits for a total of \$2.5 million. More than 4,600 new jobs have been created and more than 10,000 existing jobs have been strengthened. Each job created corresponded to an average loan of \$647, compared with \$1,758 for the FOMICRO program. Appendix I shows some numerical results of the program.

As for training, 700 courses have been given, with over 7,000 people in attendance. The main advantage of the ADMIC

Program is not only that credit is extended, but support is also given for administration and management of the business. It has been said that the shortcomings of microenterprises are lack of capital and administration; this program tries to cover both aspects.

### **Strengths and Weaknesses of Private Support**

Although there are several institutions that dedicate themselves to a greater or lesser extent to supporting microentrepreneurs, there is general agreement among the persons interviewed that support is insufficient. While some believe that the methodologies used are not adequate, most feel that the methodologies are adequate, but that they lack the institutional strength and expansion required to have a notable impact on such an enormous sector.

The most positive aspects of private sector support for microenterprises are their training programs and their ability to get financing into the hands of marginalized entrepreneurs. Granting credit to marginalized entrepreneurs is considered by some interviewees as the most important feature. Others assert that even more than the credit itself, microentrepreneurs are in need of training to make efficient use of their resources. The microentrepreneur's lack of knowledge of basic administrative practices restricts the healthy and sustained development of his or her business.

Another positive aspect mentioned is the reputation for reliability and trustworthiness that ADMIC has earned from the banks, which has reflected positively on the microenterprise sector that ADMIC represents. In 1989, ADMIC used a line of credit from BANORTE-FOGAIN for \$1.2 million for microenterprise loans with a \$100,000, or less than 10%, letter of credit used as a guarantee.

There are a great many opinions on the weaknesses of the private sector programs. The programs have not expanded widely enough for a significant percentage of entrepreneurs to take advantage of their services. There is still a tremendous demand for credit in the sector that the programs have not been able to meet, and to which the formal financial sector does not respond.

In addition, the programs do not adequately support the development of organizations of microentrepreneurs. There is

neither communication nor coordination among the organizations working with the sector. There are no organizations that represent the microentrepreneurs, and the existing associations are weak. There is not any pre-entrepreneurial support.

Furthermore, certain conditions in the private sector also have a negative impact on the microenterprise sector, but have not been addressed by the development organizations. Large businesses do not buy from the microenterprise sector, and when they do, they pay excessively low prices; there is a lack of outlets for the sector's products; there is apathy in the private sector when it comes to integrating microentrepreneurs into formal organizations; and suppliers do not offer microentrepreneurs sufficient credit. The private organizations have not confronted these issues which continue to aggravate the situation of many microentrepreneurs.

### **RELATIONS BETWEEN PRIVATE AND PUBLIC PROGRAMS**

There is disagreement regarding existing coordination between the private and public sector to support microenterprises. Half of those interviewed thought that the two sectors do not work in a coordinated manner to solve the problems affecting microentrepreneurs, while the other half felt that they do.

The reasons given to explain the lack of a coordinated strategy towards the sector are, among others:

- o The public and private sectors are not sufficiently familiar with issues facing the microenterprise sector.
- o There is a lack of communication between private and public sectors.
- o The public sector is not really committed to working with microenterprises. The informal sector is tolerated for electoral purposes and there is no serious government effort to draw microentrepreneurs into the formal economy.
- o There is excessive regulation in the public sector.
- o The public sector is not eager to coordinate its efforts with the private sector, especially in the area of financing. It is

- argued that the public sector wants to do everything independently.
- o The government programs are handled politically. Positions become polarized and there is no shared objective.
  - o There is no high-level coordinating body and consideration is not being given to the creation of such a body that could include representatives of both the private and public sectors, and pursue new ideas for meeting the needs of microenterprises.

There is clearly a lack of adequate coordination among the programs, and much remains to be done to achieve greater coordination to benefit the informal sector. The only positive influence that appears on relations is the private sector's insistence on receiving public sector assistance for its activities to support microenterprises. This insistence has resulted in the state being slightly more flexible and allowing ADMIC to expand and develop its activities with fewer constraints. For example, ADMIC has persuaded PROMICRO to allow it to participate in the program with the presentation of the same four reports required by FOGAIN, instead of the nine generally required by PROMICRO.

At present, relations between ADMIC and the government are developing smoothly and promise good results. The government has adopted the ADMIC model as one to be applied nationally, and has requested ADMIC to increase its number of offices nationwide and increase the quantity of resources earmarked for the sector. In addition, there are cases in which the already existing state funds are considering moving the administration of their microindustry programs to ADMIC, as was already done in the state of Tamaulipas. Nonetheless, as a development entity authorized by the national government to support and stimulate microenterprises, ADMIC cannot carry out banking functions, even though it wishes to at this time.

## **CONCLUSION AND STRATEGIES FOR IMPROVING RELATIONS**

The programs undertaken by the public and private sectors to foster development of microenterprise have not been very successful. In general, both the public and private programs were classified as fair to good; they could easily be improved

upon. Although the private sector focus has yielded good results, it has not had adequate coverage, given the magnitude of the problem.

The public sector, on the other hand, has not designed any overall strategy, and the resources earmarked for the sector have been limited in relation to existing needs. Furthermore, some criticize the government for monopolizing the resources of international institutions and not giving the private sector programs a chance to take advantage of those resources. Also, the legal modifications for integrating the microentrepreneurs into the formal economy have not been successful.

It is evident that there is no joint public-private sector effort to support microenterprises. The lack of an overall support strategy to consolidate existing programs in both sectors may actually have a negative impact on the microenterprise sector. The study results indicate that each sector is working quite independently, and there is no doubt that enhanced coordination would be beneficial. An agency needs to be established, with the participation of both sectors, to develop joint strategies for the strengthening of microenterprises.

Some government agencies, such as *Nacional Financiera*, have slightly improved their relations with the private sector, as they have begun to distribute more resources through private institutions such as ADMIC. Moreover, the work of ADMIC, with its integral approach, has increased the awareness of both private and public groups that such a program should be considered as a nationwide model.

The people interviewed agree that improving coordination is viable, and that improved relations would benefit micro-entrepreneurs. Several strategies were proposed, including the following:

- The public sector should give the private sector institutions access to financing from international institutions.
- ADMIC should receive more formal support from the government and be given more authority to expand its programs and propose new programs in support of the sector.
- The public and private sectors must recognize a common objective for supporting the microenterprise sector.



- The public and private sectors should hold regular meetings to coordinate their support for microenterprises, exchange experiences, share courses and seminars, and undertake joint promotion efforts.
- Joint working bodies should be established to carry out studies of the major issues facing microindustries.
- Effective coordination and communication between private and public agencies should be fostered, as well as better definition of responsibility for taking initiative in the development and implementation of strategies to support microenterprises.
- Local, decentralized, economic development councils made up of representatives of the private and public sectors, should be created.
- Information about successful private sector programs should be disseminated.
- Efforts to develop training, technical support, and financial support for the sector, both within and outside of the intermediary organizations, should be increased. It is proposed that a permanent institutional framework for offering support be established.

Improved coordination between the public sector and private initiatives will strengthen support for microenterprises, avert an overlap of functions, and help ensure an effective management of resources. Likewise, there would be greater dissemination of experiences, leading to increased knowledge of the issues facing the sector. The establishment of a joint agency would make possible expansion of services to more entrepreneurs, or at least consolidate already-established programs. Fulfilling such objectives will lead to the healthy development of the microenterprise sector.

**TABLE ONE****RESULTS OF FOMICRO (Nuevo León) and ADMIC (7 cities)**

Indicator	FOMICRO (1985-July 1989)	ADMIC (1985-August 1989)
Number of enterprises supported	753	4,045
Total amount loaned	\$3,456,777	\$2,517,528
Average loan amount	\$4,359	\$622
Jobs created	1,966	3,889
Jobs sustained	5,718	8,891
Amount loaned/jobs created	\$1,758	\$647

Source: FOMICRO: Government of the State of Nuevo León; Fondo de Garantía y Fomento a la Microindustria de Nuevo León, 1989.

ADMIC: ADMIC, A.C., Monterrey, Nuevo León, 1989.

## PARAGUAY

### EMERGING COOPERATION IN SUPPORT OF THE INFORMAL SECTOR

Luis Campos

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#### INTRODUCTION

The metropolitan area of Asunción, with just over one million inhabitants, is the largest population center in Paraguay. Various studies point out the large number of workers in the informal sector, as well as the sector's increasing percentage of the economically active population<sup>1</sup>. This trend is closely associated with two phenomena: the stagnation of formal-sector employment due to the economic crisis affecting the country, and the crisis of the traditional segment of Paraguayan agriculture. The latter, which has become aggravated since the mid-1970s, has led to rural-urban migratory flows to the metropolitan area, even though there is no corresponding availability of formal-sector employment. Consequently, the informal sector of the economy is absorbing an ever greater share of the labor market: from 1983 to 1986, the economically active population employed in the informal sector in the metropolitan area increased from 42.7% to 45.3%<sup>2</sup>.

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1. Enriquez, Gamón E. and L.A. Campos. "Estudio Sobre la Economía Informal en Paraguay", Universidad Nacional de Asunción, Facultad de Ciencias Económicas, Administrativas Contables, San Lorenzo, 1988.

2. Ibid., p. 41.

Nevertheless, the informal sector includes both a vast indigent population, with incomes below the minimum legal monthly salary (now \$150.00), and a solvent segment, with incomes equivalent to or occasionally greater than the formal-sector minimum salary<sup>3</sup>. It is this latter segment, called "microentrepreneurial," that this report addresses. The purpose of this paper is to examine government and private-sector efforts to support the growing microentrepreneurial sector. The information on the public and private institutions was obtained from personal interviews with the leaders of the programs mentioned.

### **GOVERNMENT SUPPORT FOR THE INFORMAL SECTOR**

The February 3, 1989 coup d'état, which brought an end to a government that had controlled politics in Paraguay for over thirty years, radically changed the country's political environment. Politically, one must speak of pre-coup Paraguay and post-coup Paraguay. The former government had no policy towards the informal sector, and implemented only a few small projects for promoting artisan activities. In contrast, the new government has shown an authentic commitment to the sector, though not enough time has passed to see the results of this commitment. This section describes the former government's projects, while the last section of the document examines the present government's policies and initiatives.

#### **Programs of the Previous Government**

State support for the informal sector of microentrepreneurs began in 1975 with several small technical and credit assistance programs for artisans. Four government programs have been providing services to microentrepreneurs.

The Artisan Promotion Service (*SPA: Servicio de Promoción Artesanal*) was established in 1975, under the Ministry of Industry and Commerce, to encourage artisan committees, solidarity organizations, and associations to establish artisan cooperatives. Since 1978, the program has offered credit which is granted after attendance in training courses. The credits are individual, for one year, and range from \$45 to \$210, at an annual

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3. Ibid., pp. 83-93.

interest rate of 21.5%<sup>4</sup>. There are only 50 borrowers each year, and the program is in the process of forming its first artisan cooperative.

The National Professional Promotion Service (**SNPP: Servicio Nacional de Promoción Profesional**) is a training institute established in 1975 under the Ministry of Justice and Labor. Its regular funds are from the 1% employer contribution to the Social Welfare Institute (social security). Since 1989, the SNPP has been carrying out a development project in conjunction with the Agricultural Credit Fund (**CAH: Crédito Agrícola de Rehabilitación**), which receives financial support from the World Bank. The program grants post-training loans to entrepreneurs who have participated in the SNPP. The loans are for a sum of \$2,000 to \$4,000; the loan term ranges from three to eight years, and the interest rate is 22%. To date, the program has channeled \$50,000 to 14 rural producers in Choré.

Also, in August 1989, the SNPP signed an inter-institutional cooperation agreement with the Paraguayan Foundation for Cooperation and Development. This project is designed to assess the need for training and technical assistance in the microenterprise sector, and to optimize the two institutions' use of physical, human, and financial resources.

In 1988, the Ministry of Justice and Labor, the United Nations Development Programme (UNDP) and the International Labor Organization (ILO) began implementing a project for the "Promotion of Youth Enterprises." The objective of the project is to improve the situation of youth employment in the country, establishing youth enterprises and other associative forms of production to benefit young men and women. The program offers technical assistance, training, and credit to groups of young people. Total loans are for a maximum of \$1,200, at an annual rate of 18% to be amortized in two years, with a six-month grace period. To date 46 youth enterprises have been established, and eight new ones are about to begin. As of May 1989, the program involved 116 participants, including 44 women.

The project has signed an agreement with the National Workers' Bank (**BNW: Banco Nacional de Trabajadores**) to

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4. The nominal market interest rate is 28% annually; the effective rate can be as high as 32%. Inflation has been approximately 30% in recent years.

channel loans through the BNT once the feasibility study has been completed. The plan is to transfer to the BNT the task of financing the enterprises and convert the revolving fund into a guarantee fund. At the same time, negotiations are under way with the National Development Bank (*BNF: Banco Nacional de Fomento*), which has offices nationwide, to enter into agreements similar to the one with the BNT.

The Agricultural Credit Fund (*CAH: Crédito Agrícola de Habilitación*) has 24 offices in the interior and was established in 1944. It is the only public organization that provides assistance to small agricultural producers who do not have sufficient assets to qualify for loans from the National Development Bank, the country's principal development financing agency. In 1981, the CAH began a rural artisan program to offer loans and training to the wives of borrowers who participate in the agricultural program. The entire loan portfolio came to \$24,000 in 1988-1989. The maximum loan amount is \$1,250; the term is three to five years, with an annual interest rate of 22%. At present there are 61 borrowers and the recovery rate is 97%.

### Strengths and Weaknesses of Government Programs

While government support for the informal sector arose in response to the problems of rural-urban migration and increasing unemployment caused by the economic slowdown of the 1980s, the assistance offered by the government was extremely limited.

**TABLE ONE**

#### **GOVERNMENT PROGRAMS FOR THE INFORMAL SECTOR**

Entity	SPA	SNPP	ILO/MJT	CAH	TOTAL
Revolving fund*	20.8	50.0	45.8	25.0	141.6
Number of borrowers	50	14	52	61	193
Interest rate(%)	21.5	22	18-22	22	18-22
Recovery rate(%)	88.0	90.0	93.0	97.0	92.0

\* In thousands of dollars.

The total active portfolio of the four public-sector agencies comes to \$141,600, with only 193 borrowers. The limited coverage implies a low level of risk, which may explain the high recovery rate. Considering that, according to the SPA, there are some 300,000 artisans, one can easily deduce the system's low coverage. This assistance, despite having begun in the early 1980s, is still at the experimental stage. The results of the governmental programs demonstrate the limited interest of the Paraguayan Government in the informal sector over the last three decades.

### **SUPPORT FROM PRIVATE INSTITUTIONS FOR THE INFORMAL SECTOR**

There are two private institutions that have provided services to the informal microenterprise sector since the early 1980s, the National Council of Charitable Agencies and the Paraguayan Foundation for Cooperation and Development.

The National Council of Charitable Agencies (**CONEB: Consejo Nacional de Entidades de Beneficencia**) was established in 1962, and is comprised of a variety of Paraguayan charitable institutions. Since 1982, it has been implementing an assistance program to the artisan sector with funds from two loans granted by the Inter-American Development Bank (IDB) for a total of \$1,000,000. The program is directed to artisans of the central area (Asunción, Itá, and Areguá), and the Misiones area (San Miguel, San Juan, and Santa María). The assistance includes an obligatory training course in family education, fund management, and the establishment of associations.

The program's beneficiaries are organized in 12 associations, each with some 60 members. At present the program has approximately 600 active borrowers. The loans are on an individual basis, and the maximum loan amount per artisan is \$210; the maximum term of amortization is three years, and the interest rate is 12% annually. The late payment rate is 22% of the loan portfolio.

The Paraguayan Foundation for Cooperation and Development was founded in 1985, and is affiliated with ACCION International/ AITEC. The Foundation offers credit and training to microentrepreneurs who already have a defined area of activity and a growing market. Training is a requirement for receiving loans, and is repeated each time the loans are renewed.

The maximum loan amount is \$1000, while the average annual loan is for \$200. Loan terms for microentrepreneurs in commerce are two months and interest is 36% annually on the original loan amount. For microentrepreneurs in production, loans are for four months with an interest rate of 36% on the outstanding balance. Of the total portfolio, 36% is invested in productive enterprises and the rest in enterprises engaged in commerce.

The institution's total active portfolio, as of August 1989, came to \$166,667 and the program had disbursed a total of \$711,667 in loans. There are 4,712 borrowers, 60% of whom are women. They are organized in 1,496 solidarity groups, which collectively assume responsibility for each member's loan. The on-time recovery rate is 91% with 4% of payments in arrears and the rest considered uncollectible.

The available loan fund of the Paraguayan Foundation is composed of funds from: 1) a variety of grants, for a sum of \$50,000; 2) credits for a total of \$800,000 from the local commercial banks, the National Development Bank, and the National Workers' Bank; and, 3) a loan from the Inter-American Development Bank for \$500,000. Fund availability is high because the program is preparing for a large expansion to secondary cities and cannot depend on liquidity in the Paraguayan banking system to finance that expansion.

### **Strengths and Weaknesses of the Private Sector Programs**

The first conclusion is that the two private institutions are providing more assistance to the informal sector than the government programs, in terms of the active portfolio, the sum of revolving funds available, and the number of borrowers. The active portfolio of CONEB and the Paraguayan Foundation totalled over \$219,000 compared to \$141,600 in the public sector. There are well over a million dollars in loan funds available through the private programs, and only \$175,000 available through the government programs. A total of 5,312 microentrepreneurs borrow from the two private institutions just mentioned; this figure contrasts sharply with the 193 people benefited by the official programs.



### PRIVATE SUPPORT TO THE INFORMAL SECTOR

Entity	CONEB	Fundación Paraguaya	TOTAL
Revolving fund*	52.5	166.6	219.1
Number of borrowers	600	4,712	5,312
Interest Rate (%)	12.0	36.0	12/36
Recovery Rate (%)	88.0	95.0	88/95

(\*) In thousands of dollars.

A study of a sample of 85 beneficiaries of the Paraguayan Foundation<sup>5</sup> reveals the benefits that the program has produced. After six months in the program:

- the beneficiaries' average sales volume increased by 41.5%;
- inventories increased by 65.9% and net profits by 34.7%;
- fixed assets grew 36%, even though loans are only for working capital, indicating a possible tendency to reinvest profits;
- the family welfare of the beneficiaries improved, as domestic expenditures increased an average of 14%;
- there has been a decline in the beneficiaries' dependence on the traditional sources of informal-sector financing;
- 100% of those who initially received a loan requested a second one, thus reflecting client satisfaction.

### PUBLIC AND PRIVATE PROGRAMS: RELATIONS AND OUTLOOK

As has been seen, the government that dominated Paraguay for over thirty years showed little interest in marginalized

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5. Magill, John H. and Arelis Alfonso Gómez, "Evaluación Sobre El Terreno del Programa de Microempresa de la Fundación Paraguaya de Cooperación y Desarrollo". Development Alternatives, Inc., Washington, November 1988, pp. 7-19.

sectors of the country's population. It never attempted any program for the informal sector that would involve more than 100 entrepreneurs. Nor were there private programs to assist the sector until 1982, when CONEB was founded, and then 1985 with the founding of the Paraguayan Foundation. These organizations began their work in isolation from the government, without either support or active opposition from the state.

The February 3, 1989 military coup radically changed the political environment in Paraguay. Today there is a political opening for all sectors, including the informal sector of the economy. The current government, from the beginning, has shown greater sensitivity to the social sectors in need, and has committed itself to placing greater priority on addressing their problems.

Consequently, there is a new attitude on the part of the government towards programs directed to the informal sector by non-governmental organizations. The government recognizes the contribution of these organizations to the country's development. A process of cooperation and definition of roles, based on mutual respect, fluid exchange, and monetary support is currently under way between the government and NGOs. As this is such a new process, it is impossible to speak of results. Nevertheless, there is substantial evidence of the new government's commitment to cooperate with private organizations to resolve the problems of poverty in the informal sector.

President Andrés Rodríguez promised in his election campaign to provide financial support to the microentrepreneurs of Market 4 to release them from the grasp of usurious moneylenders; he then worked with the Paraguayan Foundation to extend its program to that market.

The government has involved NGO representatives in its development-oriented agencies. The Executive Director of the Paraguayan Foundation serves as the Deputy Coordinator of the National Council of Coordination for Rural Development, and several NGOs are represented on the National Housing Council.

The National Development Plan speaks of the importance of the informal sector to the Paraguayan economy, and

recognizes the effort and achievements of the institutions that have been supporting this sector.

- o From 1991 to 1993 the operations of the Paraguayan Foundation are to be expanded to serve the most important urban centers of Paraguay's eastern region. Public funds are expected to be forthcoming, along with close cooperation from the central government and municipal governments of the interior.

The National Workers' Bank and the National Development Bank have shown greater flexibility in facilitating lines of credit for a sum of \$330,000 for the Paraguayan Foundation, respecting the Foundation's unique credit mechanism and philosophy. This attitude is a reflection of the government's new attitude.

Agreements for cooperation have been formalized in the area of professional training, between the National Professional Promotion Service and the Paraguayan Foundation.

There are two highly unlikely possibilities in the current situation in Paraguay, which could have negative repercussions on the government's new attitude and relations with the private sector institutions. One is the possibility of a major step backwards in the political situation, such as another coup; the other is the possibility of a deep economic recession that would force the government to cut back its assistance programs.

However, the most likely scenario is that the cooperation and mutual support being nurtured between the government and private organizations will continue and increase, to the benefit of the informal sector. To a great extent the government's sensitivity towards the informal sector depends on the initiatives of non-governmental organizations which, in recent years, have accumulated invaluable experience working with microentrepreneurs. In addition, new institutions supporting the informal sector, both public and private, can be expected to emerge. The process that is beginning today in Paraguay appears to point to a brighter future for the marginal sectors and for the organizations that support them.

**APPENDIX I**

**ACRONYMS**

**IDB:** Inter-American Development Bank

**BNF:** Banco Nacional de Fomento/National Development Bank

**BNT:** Banco Nacional de Trabajadores/National Workers' Bank

**CAH:** Crédito Agrícola de Habitación/Agricultural Credit Fund

**CONEB:** Consejo Nacional de Entidades de Beneficencia/National Council of Charitable Agencies

**ILO:** International Labor Organization

**UNDP:** United Nations Development Programme

**SNPP:** Servicio Nacional de Promoción Profesional/ National Service for Professional Promotion

**SPA:** Servicio de Promoción Artesanal/Artisan Promotion Service

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## **PERU**

### **GOVERNMENTAL AND NON-GOVERNMENTAL SUPPORT PROGRAMS: REFLECTION AND ASSESSMENT**

Eliana Chavez O'Brien

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#### **INTRODUCTION**

This document studies urban informal sector (UIS) programs implemented by government and private institutions in Peru, and assesses their strengths, weaknesses, and impact on both the informal sector and the country as a whole. The observations, criticisms, and suggestions contained herein are drawn from many conversations with members of the target group, leaders of their organizations, and experts from private institutions, research centers, and other relevant institutions. This paper also reflects conversations with representatives of political parties and the government. These inputs have enhanced this essay, which aims to explore some possible solutions to the problem of poverty which so harshly impacts Peru.

#### **GOVERNMENTAL POLICIES TOWARDS THE URBAN INFORMAL SECTOR**

Since coming to power in 1985, the government of the ruling American Popular Revolutionary Alliance (APRA) has departed from the policies of the previous government and recognized the

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need to include the informal sector in an overall economic strategy. This strategy rejects the economic formulas of the International Monetary Fund, limits payment of the foreign debt to 10% of export earnings, protects the domestic market, redistributes income, and promotes investment. The strategy is based on an analysis of inflation which incorporates the cost of recession to entrepreneurs. The theory argues that both inflation and recession can be countered by stimulating demand through wage hikes, promoting prices favorable to the peasant population, and providing support to the urban informal sector which, in 1985, accounted for 33% of the economically active population.

### **Government Assessment of the Urban Informal Sector**

The government assessment, based on research from the Center for Development and Participation Studies (*CEDEP: Centro de Estudios para el Desarrollo y la Participación*) and the Ministry of Labor, recognizes the dual origins of the urban informal sector, one of which is structural. This structural origin is the disproportionate rate of growth of the urban labor market as compared to the demand for labor in the formal or modern sector. In 1985, this disproportionate ratio resulted in the exclusion of 33% of the labor force from the jobs created by the formal sector. This exclusion is structural and long-term, as it is measured against labor demand when installed capacity is at full use. There is also a short-term cause whose magnitude varies with the cyclical trends in the economy. As such, growth of the informal sector occurs as an adjustment to open unemployment.

In the proposed approach, the concept of "informality" is defined as: exclusion from the modern sector and the establishment of self-generated productive units. Adopting this approach, the APRA government identified two critical obstacles that must be overcome in order to support and include the informal sector in the economic recovery. The first barrier was the inaccessibility of the formal-sector financial systems to informal-sector entrepreneurs. This situation was particularly frustrating considering the limited capital required to establish an informal productive unit. The second limitation was the low level of technical and management capability of urban informal sector workers, a characteristic that both endangers the stability of businesses in the sector, and limits their growth potential.

Recognizing these limitations, the government program focused on two goals: to promote access to formal credit; and to improve the managerial capacity of the urban informal sector. In this way, greater levels of accumulation, stability, and income would be encouraged and unemployment reduced. From the demand side, an increase in formal-sector wages would foster increased demand for the goods produced by the informal sector.

To translate these objectives into working programs, two options were discussed. The first was to operate through the state institutions, such as the Ministry of Labor which had previously administered the Informal Sector Guarantee Fund (*FOGASI: Fondo de Garantías al Sector Informal*). The second option entailed establishing a non-governmental organization. Although the new NGO would be private, the massive government support to the urban informal sector would be channeled through it.

The bureaucracy of the central government, its inefficiency, and the shortage of technical personnel contributed to the decision to establish the Institute for Development of the Informal Sector (*IDESI: Instituto de Desarrollo del Sector Informal*). This NGO developed its activities in close coordination with the central government, financial institutions, and merchant and producer organizations. IDESI is a private organization and is analyzed in a later section with the other non-governmental organizations.

The state institutions offering massive credit were primarily the financial institutions, and the National Planning Institute which coordinates activities between institutions working in the urban informal sector. The National Planning Institute adopted policies favorable to urban entrepreneurs in its development plans for the first time.

These institutions were supported by President Alan García, who consistently implemented policies in favor of the informal sector. His general development policy aimed to reduce inflation and keep down the cost of basic services that are important in the cost structure of small businesses such as electricity, water, and gasoline. The policy also advocated an increase in real salaries to improve the buying power of the salaried population.

All of these policies were beneficial to informal sector microenterprises.<sup>1</sup>

### **Government Support to the Urban Informal Sector**

The García Administration made several efforts to modify the traditional role of the national financial system which is generally characterized as centrist and oriented towards big business. This section briefly describes some of the specific changes in the financial system.

1. In September 1985, the country was divided into eight financial districts to promote institutional decentralization of the financial agencies and to guarantee that resources would be invested in the financial districts from which they originated.
2. The National Development Bank (*Banco Nacional de Desarrollo*) project established a multi-sectoral decentralized bank for each financial district.
3. A series of loan funds was established for the informal sector.
  - o The Industrial Bank of Peru (*BIP: Banco Industrial de Perú*) created the Fund for Financing the Informal Sector (*FOFISI: Fondo de Financiamiento del Sector Informal*) in 1986 with the transfer of 40 million intis (\$2,860,000)<sup>2</sup> from the national treasury. FOFISI loans were restricted to individuals and groups involved in production, commerce, and services (not subject to legal regulation), and whose potential annual sales were not more than \$34,800, one-fifth the maximum sales volume for small businesses<sup>3</sup>. After one and a half years, total loans came to only \$35,800 or 1% of FOFISI's loan capital.
  - o The National Fund for Credit to the Urban Informal Sector (*FONCRESI: Fondo Nacional de Crédito al Sector*

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1. Chávez, Eliana, "La Disminución del Empleo y el Rol del Sector Informal Urbano en el Período 1985 a 1989", *Socialismo y Participación*, No. 49.

2. All currency figures have been converted to U.S. dollars

3. Report on FOFISI written by the Division of Small Enterprise and Crafts (División de Pequeña Empresa y Artesanía), Industrial Bank of Peru, 1986.



**Informal Urbano)** was established with \$10 million from the national treasury. Since 1986, the Agrarian Bank (**Banco Agrario**), in collaboration with IDESI, has loaned these resources to more than 10,000 clients in the departments of Cuzco, Puno, Ayacucho, Apurímac, and Huancavelica. Paradoxically, this level of execution gives the Agrarian Bank a more dynamic role in serving microenterprises than the Industrial Bank. By late 1986 this fund was also being disbursed by the **Central de Crédito Cooperativo**, the **Caja Municipal de Lima**, and the **Banco Continental**. Only the **Central de Crédito Cooperativo** and the **Banco Agrario** made loans in the provinces.

- The Fund for Financing Overland Transport (**FOFITT: Fondo de Financiamiento al Transporte Terrestre**) is managed by the **Banco de la Nación** to promote greater efficiency in the public transport system; where more than 90% of public transport is concentrated in the hands of informal-sector entrepreneurs. Its funds are raised from the 6% tax on gasoline. Despite the shortage of public transportation, FOFITT's level of disbursement has not surpassed 2% of its resources.

### **Strengths of Government Support to the Sector**

In general, the positive long-term effect of the government's support is due to the attention focused on the sector by the government and other national and international agencies. In the short term, a positive impact was felt in other areas, such as:

- For the first time Peru proposed an economic recovery program that included policies and programs for providing comprehensive support to the urban informal sector. The implementation of these policies during the reactivation process contributed to rising employment rates and increased incomes among the very poor in 1986 and 1987.
- A process was initiated to democratize access to credit and decentralize its distribution. This process, discussed below, was cut short because the conditions for restructuring the financial system and the state-owned development banking system did not materialize. Nonetheless, this process demonstrated the capacity of small entrepreneurs to repay loans with low default rates. At the same time,

microentrepreneurs became familiar with the formal financial sector.

- The organizations within the informal sector were strengthened. In the medium term, this development may make it possible for members of the informal sector, given their numbers, to become an important social force for any process of structural change.
- There was an increase in the number of programs aimed at supporting the sector. The urban informal sector became a visible priority and, as such, it was possible for many public and private institutions, both national and international, to initiate or strengthen programs to support the sector. In an economy in which 45% of the economically active population is in the informal sector (1988), this is a major contribution.

#### **Weaknesses of Government Support to the Sector**

- A short-term recovery program was designed, but not linked to any medium- or long-term process of structural change in which small businesses and microenterprises would play a fundamental role. This lack of articulation, perhaps the most egregious error within government policies in general, resulted in an economic crisis that has had catastrophic consequences for both microenterprises and the country as a whole.
- Instead of a program of comprehensive support to the urban informal sector, a massive credit program was implemented that grew quantitatively but not qualitatively. It was not clear whether the strategy was geared towards enterprise growth or survival, nor was there a clear definition of the target group, its type of activity, size, or potential. The entrepreneurs did not participate in defining the problems or in selecting the methodology. Nor was there any follow-up program.
- The obstacles to obtaining formal-sector financing for the informal sector were not overcome, despite the emphasis placed on credit. Factors cited for limiting access to formal-sector credit are the perceived greater potential credit risk of microentrepreneurs and the high cost of processing extremely small loans for new clients. Thus, even when there was an apparent surplus of loanable funds, informal sector

participants still had limited access to them. If these really are the limiting factors, and if there is a political will in the medium term, it appears possible to design appropriate methodologies for the formal banking system or the development banking system to work directly with the microenterprise sector.

The government support did not respond adequately to the training needs identified by the microentrepreneurs. It appears that this activity has not been given due priority.

The government support failed to undertake coordinated efforts with other institutions linked to the sector, such as: non-governmental organizations, municipal governments, churches, unions, and even other state institutions. A coordination of efforts is essential for taking on the problems generated by such rapid growth of the population employed in the urban informal sector.

## **PRIVATE INSTITUTIONS THAT SUPPORT THE INFORMAL SECTOR**

IDESI and FOGASI are private non-profit institutions that were established under government tutelage. IDESI was created in 1986 and maintains its original link to the government and state agencies, even though this bond has gradually loosened. Its objectives are: to carry out programs in support of the urban informal sector in the areas of credit, training, organizing associations, and social security; to give direction to state action in formulating policies for the informal sector; and to encourage the national financial system to develop direct action programs.

FOGASI was established in 1985 to develop a pilot program to address the needs of the urban informal sector. The program began with the creation of a loan guarantee fund. Program activities began under an agreement between the Ministry of Labor and the Organization of American States. The program was discontinued in 1988 due to financial problems.

The two programs have yielded the following results:

Indicator	IDESI (1986-89)	FOGASI (1985-88)
Number of loans:	267,000	10,365
Total value of loans:	\$2,574,066	\$930,285
Number of participants:	65,000	2,900
Beneficiaries of training:	63,667	2,000
Arrears:	3%	8%

### Private Institutions Independent of the Government

Three private institutions have had a significant impact on the urban informal sector.

**ACCION COMUNITARIA** was established in 1969 as an initiative by a group of Peruvian entrepreneurs to contribute to the solution of the socioeconomic problems of low-income communities. The Association for the Development and Integration of Women (**ADIM: Asociación para el Desarrollo e Integración de la Mujer**) was established to promote economic activities that would benefit women through action and research programs. The third private institution, The United Christian Association for Development (**ACUDE: Asociación Cristiana Unida para el Desarrollo**) works to promote the development and viability of small businesses through programs of credit, training, and entrepreneurial advisory services. The achievements of the three programs are as follows:

Indicator	ACCION COMUNITARIA (1982-1988)	ADIM (1985-89)	ACUDE (1985-89)
Number of loans:	22,009	14,162	162
Total value of loans (\$):	18,784,777	2,368,645	1,302,616
Number of participants:	6,785	3,356	1,422
Number of courses:	368	-	71
Beneficiaries of training:	11,205	4,486	1,422
Cost per unit (1988) (\$):	.22	.36	-
Average arrearage rate:	4.5%	9.58%	7%

## **Impact of the Private Institutions**

The following summary briefly outlines some of the positive outcomes of the NGO programs working with urban informal sector enterprises.

The institutions have increased the awareness level of governmental and non-governmental institutions, both national and foreign, about the economic and social potential of this sector of the economy.

While there is no overall assessment of the economic impact of the microenterprise programs, the empirical data appears to indicate that economic variables, such as the productivity of working capital, yield of assets, and total assets, have increased significantly as compared to other firms.

Private programs have not met general expectations of their capacity to generate employment and income. Although there has been growth in the total number of workers employed in some enterprises that have benefited from the programs, the quality of employment has not improved. Furthermore, improving employment and incomes is directly related to economic and wage policies, which are determined by the government. The private institutions could, however, provide more adequate tools, in accordance with their experience, for formulation of employment and wage policies.

The greatest impact on the financial system has been to lay the groundwork for future changes in private financial institutions and state development financing agencies. Microentrepreneurs have demonstrated, through low arrearage rates in private programs, that they are credit-worthy. Also, through private programs, informal-sector workers become comfortable with the financial system. But, as was noted above, formal-sector credit for the informal sector remains very limited due to the perceived risk and high cost of processing small loans.

Private institutions contribute positive images of private enterprise, the country, and the potential for development through microenterprise. Similarly, as a result of the programs, the beneficiaries have improved their housing and

purchased home appliances which implies a better quality of life in the home.

Another beneficial impact of private programs is the strengthening of associations of microentrepreneurs. NGOs have made it possible to consolidate these organizations and empower them to represent their own interests.

### **Weaknesses of Private Programs**

Private programs are faced with the same challenges as governmental programs and exhibit many of the same weaknesses.

- The fundamental objective of providing access to formal sector financing for the informal sector has not been attained.
- The training has not corresponded to the beneficiaries' real needs.
- The activities have not been accompanied by empirical research that orients the programs' actions, nor by a process of ongoing evaluation between those who carry out the programs, the beneficiaries, and related institutions.
- Efforts to organize microentrepreneurs have been insufficient. If the empowerment of associations within the sector is a fundamental condition for the government to extend more effective support (and also for the activities within the sector to become more efficient), this line of action must receive greater priority.
- Very little has been done to increase the degree of inter-institutional activity, which has led to a duplication of efforts and lessened the impact of institutions and their microenterprise programs.

### **SUPPORT PROGRAMS AND THEIR RELATIONSHIP TO THE STATE**

The central question facing low-income microentrepreneurs, the private support institutions, and the state is: How can the three levels of key actors who converge in what we call the informal sector fight poverty effectively and democratically?

In Peru, the experience of providing support to the poor sectors through employment- and income-generating programs is relatively new. Until the 1980s, emphasis was placed on increasing levels of awareness and organization within the target group. This changed as the formal sector was unable to create sufficient employment, the informal sector grew, and social and economic gaps between sectors of the population widened. In recent years, growth of the informal sector (47% of the economically active population in 1989) is so rapid, and has reached such a high level, that no self-respecting private development organization can ignore it.

Development institutions responded more quickly than the state with economic strategies to help the poorest urban sectors adjust to the crisis weakening Peru's economy. APRA was the first government to include the informal sector in its policies and support it financially through IDESI. Relations between private institutions and the state are in the first of several stages of development and have not yet produced any conclusions.

### **Development of the Relationship**

Initially, the highest levels of the Peruvian government expressed interest in working in a coordinated fashion with private institutions. However, instead of fostering coordination at the institutional level, this initiative did not go beyond personal relationships among relatively few professionals. At the same time, the private institutions, many of which were becoming consolidated, were fearful of losing their autonomy and independence if they worked too closely with the government. Therefore, relations between the public sector and the private institutions were frequently characterized by mutual reserve and suspicion.

Between 1986 and 1987, the government made significant strides in its economic recovery policy, including an increase in employment and income in the urban informal sector. The successes strengthened the government and solidified its role as a collaborator with the popular sectors. In this period, relations between the public and private sectors weakened, as the government felt capable of confronting poverty without outside help.

In 1988, the first signs of crisis appeared, resulting from a short-term economic recovery process that was not articulated

to any medium- or long-term strategy. Given the level of poverty, the informal sector workers were harder hit by the crisis than other sectors because of an increased supply of informal-sector workers as well as a reduced demand for informal-sector products due to the decrease in formal-sector wages. The crisis mobilized non-governmental and public sector organizations (CEDEP, CIPDEL, GREDES, COFIDE, the Ministry of Industry) to consult with other organizations with experience working with the informal sector to assess experiences and methodologies. This collaboration was a major step towards inter-institutional cooperation<sup>4</sup>.

In 1989, the crisis became full blown. Working conditions became extremely difficult for the target groups as well as for the institutions supporting them, greatly decreasing the credibility of the government. Relations with the state became practically non-existent, except in very specific projects. This is the current status of relations between the state and the private institutions that support the urban informal sector. Nevertheless, the experiences of both private and public institutions suggest the possibility of a greater disposition to work together for the benefit of the microenterprise sector.

### **Factors that Weaken the Relationship**

Several factors have hindered the development of a productive relationship between the public and private sector institutions working with the informal sector.

- The government lacks a long-term strategy to deal with the economic crisis.
- The state has disintegrated, which reflects an inefficient, inoperative, and in some cases, corrupt bureaucracy.
- The government lacks resources, which impedes the implementation or continuation of projects.
- Institutional rivalries stand in the way of a productive exchange of experiences as well as greater coordination among the institutions.

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4. Ebert Foundation, 1989, "Primer Encuentro Interinstitucional en Apoyo a la Pequeña Empresa".



**Factors that Promote Improved Relations.**

On the other hand, there are several factors that encourage improved relations between the sectors, some in the interest of the government institutions and others in the interest of the private institutions.

Local and national leaders with links to non-governmental organizations are committed to promoting the generation of employment and income in the informal sector. They can strengthen state programs with their capacity to:

- publicize the problems of the popular sectors, which the state sometimes fails to do for political reasons;
- reach the target groups more easily and with greater credibility than the government;
- encourage analysis and reflection of the local economic problems and their solutions, something the public sector does not do;
- maintain greater autonomy and credibility with the target group and its organizations.

From the standpoint of the private institutions, the factors that encourage a better relationship with the state include the possibility of:

- converting their activities, which in most cases are experimental, into massive programs encompassing a significant portion of the urban informal sector;
- testing and reformulating methodologies in relation to broader programs;
- empowering the target groups and providing them with the opportunity to delineate policy orientations for the sector that can be assumed by the state.

Moreover, neither governmental nor private organizations have implemented training programs that respond to the needs of microentrepreneurs in the informal sector. This is an area of vital importance in managing the enterprises, and there is an urgent need to design training methodologies that help

microentrepreneurs reach their productive potential. This weakness, if it is to be overcome, requires the participation of public and private sector institutions.

These motives indicate that it is not only feasible, but also necessary and desirable, for private institutions to develop activities in coordination with the public sector. It will make the work of both actors more efficient, and will result in concrete benefits for the informal sector. This will be possible only if the informal workers themselves define their needs and participate permanently in the development and evaluation of the programs. Furthermore, it is essential for each of the actors - the target group, private institutions, and public sector - to maintain their independence and autonomy.

Given the current situation and the existing possibilities, it should be noted that the political outlook for the urban informal sector could change considerably with the change of government in Peru in 1990. While the APRA government made some efforts to support microentrepreneurs, the next government will face an equally critical situation, with an even larger informal sector.

**APPENDIX I****ACRONYMS**

**ACUDE:** Asociación Cristiana Unida para el Desarrollo/  
Christian Association United for Development

**ADIM:** Asociación para el Desarrollo e Integración de la  
Mujer/Association for the Development and Integration of  
Women

**BIP:** Banco Industrial de Perú/Industrial Bank of Peru

**CEDEP:** Centro de Estudios para el Desarrollo y la  
Participación/Center for Development and Participation Studies

**CIPDEL:** Centro de Ingeniería para el Desarrollo Laboral/  
Engineering Center for Labor Development

**COFIDE:** Corporación Financiera para el Desarrollo/ Financial  
Corporation for Development

**FOFISI:** Fondo de Financiamiento del Sector Informal/Fund  
for Financing of the Informal Sector

**FOFITT:** Fondo de Financiamiento al Transporte Terrestre/  
Fund for Financing Overland Transport

**FOGASI:** Fondo de Garantías al Sector Informal/Informal  
Sector Guarantee Fund

**FONCRESI:** Fondo Nacional de Crédito al Sector Informal  
Urbano/National Fund for Credit to the Urban Informal Sector

**GREDES:** Grupo de Estudios para el Desarrollo/Group for  
Development Studies

**IDESI:** Instituto de Desarrollo del Sector Informal/ Institute for  
Development of the Informal Sector

**NGO:** Non-governmental organization

**UIS:** Urban informal sector

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