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**LINKAGES, PRODUCTIVITY AND PROSPERITY: HOW MACRO LEVEL TARIFF  
POLICIES AND FREE ZONES AFFECT TEXTILE/CLOTHING  
MICROENTERPRISES IN THE DOMINICAN REPUBLIC**

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I. INTRODUCTION

Today's prevailing prescriptions for development promote such remedies as trade liberalization, export manufacturing and emphasis on the private sector. But the U.S. Agency for International Development recently has reemphasized some of the older goals of "development with equity," including poverty alleviation. Both strands of development policy and practice most clearly intersect in the area of income growth for the owners and workers in urban informal sector microenterprises.

This report describes the results of Rapid Rural Appraisal (RRA) research (discussed below) carried out in May 1994 to explore two important "linkage" questions raised by the USAID/Dominican Republic Mission. Both involve how the macro level of free zones and tariff policies affect the micro level of microentrepreneurs and their workers - and vice versa. First, how much linkage exists between the large-scale companies of the numerous Dominican export processing zones (zonas francas) and the microenterprises of the informal sector? Second, how and to what extent do inconsistencies in tariff policies affect the economic fortunes of such microenterprises?

In order to explore these topics, it was decided to focus on clients of ADEMI (Asociacion para el Desarrollo de Microempresas, Inc.) engaged in the clothing/textile sector (rama de confeccion). In April, a one-page questionnaire was jointly designed by ADEMI management and the author (see Appendix A). It called for a summary of financial data on selected Santo Domingo confeccion clients and also asked if they (a) had ex-operators who previously had worked in the zonas francas, (b) had sub-contracts with a zona franca firm, and/or (c) produced for export. The questionnaire was filled out by ADEMI loan officers (asesores), presumably only for those clients whose scale of operation was large enough to realistically expect a "yes" answer to at least one of the three questions.

On March 31, 1994, ADEMI had 1,312 confeccion clients.<sup>1</sup> The asesores for the Santo Domingo area filled out questionnaires on 181 of these 1,312 (13.8 percent) by first pulling the financial data off the computer and then asking the client the three questions about zona franca ex-operators, sub-contracts and exporting. Of the 181, 25 clients (13.8 percent) claimed to have

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<sup>1</sup>ADEMI Informe Trimestral (Enero-Marzo 1994), p. 17.

ex-operators, two reported having sub-contracts and three said that they produced for export.

For the RRA, 11 of those 25 clients were visited (44.0 percent). This resulted in interviews with 14 owners and nine of their workers with zona franca experience. In two firms, the workers were interviewed in small group meetings (of two and three workers, respectively) without the owners nearby. In the others, worker interviews were one-on-one but the owners were present for at least part of the interview. In addition, six asesores and four ADEMI managers were interviewed as key informants. Here is the list of interviewees, broken down by gender:

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**Table 1: Interviewees for Macro-Micro Linkages Study**

	<u>Men</u>	<u>Women</u>
<b><u>A. Microenterprises</u></b>		
<u>Owners</u> (N=14)	5	9
<u>Workers</u> (N=9)	6	3
<b><u>B. ADEMI</u></b>		
<u>Asesores</u> (N=6)	6	
<u>Managers</u> (N=4)	4	
	<u>21</u>	<u>12</u> (Total=33)

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Since the sample is non-random, it is not possible to infer to all ADEMI confeccion clients or workers. Nevertheless, the study uses the most important feature of RRA methodology, involving "triangulation," or cross-validation of data. This is done by limiting RRA research to a small number of variables and getting at least two sources of data - preferably by two different methods - for the variables of inter st. Here, both individual and group interviews were used, involving four different groups (see Table 1), along with the computer-supplied financial data and the clients' responses to asesores' questions.

In general, there was high consensus among all people interviewed. Only one contradiction emerged, involving the owners of one microenterprise who argued - against the otherwise unanimous reports of 12 other owners and all nine workers - that operators could make more money in the zonas francas than in microenterprise clothing/textile workshops. Everyone else claimed the contrary.

## II. LINKS BETWEEN FREE ZONES AND MICROENTERPRISES

Technology and productivity transfer: The first issue explored was the extent to which ex-employees from the zonas francas were involved in the microenterprises visited. Unexpectedly, in three of the 11 ventures, one or more of the owners was a veteran of the zonas francas. This included a woman's clothing business where the wife, who was in charge of production, had a free zone background as both operator and supervisor. It also included a bedspread and sheet workshop whose owner had worked his way up to supervisor and then plant manager of a free zone firm before starting his own venture with his wife, who herself had been an operator in one of the zones. The third case was a man who had been an operator and a mechanic in a zona franca before opening his own workshop, producing made-to-measure clothes and uniforms.

Owners of seven of the 11 enterprises - including the three run by free zone veterans - agreed that it was a positive thing to employ ex-operators from the zones. All noted that they were trained to be fast and accurate, especially in finishing (terminacion). Although all also agreed that the ex-operators frequently were trained on the latest machines, only two owners mentioned this technology transfer as a benefit. Rather, it was the productivity and work discipline of the ex-free zone operators that was most often noted. This meant that owners were able to increase their own productivity by hiring the ex-operators.

Owners of three of the 11 businesses found no major difference between free zone veterans and other employees. The owner of the lith thought that they were hard to retrain because they were excessively specialized: they were used to working on one small task in the free zone factories, whereas in a microenterprise workshop generalists made better employees.

These results emphasize improvements to productivity rather than technology transfer as ex-free zone employees' biggest contribution to the microenterprise sector. Nevertheless, one of the asesores, who is doing a master's thesis on a case study of one of the workshops visited, argued that technology transfer does occur. For example, owners might be more willing to get more modern equipment if they know they have trained, fast and accurate workers to use it. And two of the owners mentioned this very point.

The free zone veterans had learned their speed and accurate finishing the hard way. A theme that emerged in the interviews with all nine ex-operators was the high pressure, forced pace of work in the free zone factories. They liked being able to choose their own pace in the microenterprises - but still were able to produce enough to make considerably more money than in the zones.

Wage differentials: As noted, all the ex-operators and owners of 10 of 11 microenterprises claimed that it was possible to make

more in a small workshop. The magnitude of the difference most frequently mentioned was 3:4 or 5 - i.e., those who made the minimum free zone salary of about 300 pesos a week could make 400-500 in a microenterprise. This was because quality control standards were so demanding in the free zones that workers frequently had large batches of their production rejected for minor imperfections. They not only had to redo these for no extra pay, but lost the productivity bonus (ajuste) that above-quota production brought them. In the microenterprises, they did more varied work under less pressure - but still with enough accuracy - to earn more.

Working condition differentials: Once again, workers and most owners agreed on why it might be more pleasant to work in a tiny, crowded workshop than a large, modern plant. As noted, the most common complaint of the workers was the low earnings. The second reason was feelings of being exploited in the free zones - although a couple of the women ex-operators emphasized that they had been very well treated by the management of the company for which they had worked. Still, all workers agreed that one worked under a sense of constant pressure, with no respite. For example, all noted that lunches were extremely brief in the free zones - as short as 15-20 minutes. One worker told of being charged 100 pesos a week for those fast lunches, almost a third of the basic minimum wage.

Whereas free zone lunches were short, the 11 workshops gave a long enough lunch period (1-2 hours) for workers to go home. All but one of the ex-operators worked closer to home in the workshop than in the zona franca and all but two were able to go home for lunch on foot. This permitted them to save both time and money.

All nine workers agreed that more personal relationships with the owners were another advantage of working in a microenterprise. They did not receive benefits in their current jobs but claimed that their free zone employment's major benefit was social security health coverage. Not all were satisfied with the treatment and/or had not had occasion to use it. Since they were mostly young and healthy, they tended to discount the lack of benefits in their informal sector jobs.

Other negatives were mentioned about free zone factories, such as firms not paying appropriate severance pay to the laid off, or firing workers who were injured. But it was not possible to get independent verification in the brief period of the study.<sup>2</sup>

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<sup>2</sup> In one case, both a co-worker and the owner told about a young man who used to work in the San Pedro de Macoris free zone. He had lost the vision in one eye when a piece of his machine snapped off. Rather than pay his medical expenses, the firm fired him one week later, they alleged. He came to Santo Domingo to pursue his claim with the appropriate government ministries, and

Even so, the workers and owners agreed that some people found zona franca employment more attractive. A number had relatives or friends who chose to remain in the zones. Since there are more operators looking for work than jobs, there is a lot of movement in the clothing/textile sector. An operator might have reason to stay in a reasonably stable post, whether microenterprise or free zone.

Sub-contracts. Only two clients told their asesores they had free zone sub-contracts, so a special effort was made to visit one. This involved returning three times until we found the owner. But when queried, he claimed he had misunderstood the question and had no zona franca sub-contract. He was one of the three owners with free zone experience, so the interview was fruitful anyway.

The only data obtained on sub-contracts came from two of the owners of a baby clothes business that was by far the largest firm visited. They told of two acquaintances who had come to grief from sub-contracts because they bought all kinds of specialized machines that they had little use for once the arrangement ended.

As in the famous Sherlock Holmes story where the important point was that "the dog did not bark," the near-total absence of sub-contracts in the sample of 181 microentrepreneurs is what merits comment. Social scientists such as Alejandro Portes and Saskia Sassen-Koob, and Lourdes Beneria, have speculated about chains of sub-contracts that reach out from the export processing zones all the way down to the homeworkers who, indeed, are a fixture in many countries' informal sectors.<sup>3</sup>

But the lack of sub-contracts between the free zones and the microentrepreneurs implies that this hypothesized chain does not exist in the Dominican Republic. In fact, questions to both sides about the pros and cons of such arrangements might be worth asking about in a future study. Is the absence of sub-contracts due to legal constraints, lack of interest by one or both parties, lack of information by one or both parties, or...?

Exporting. We deliberately visited two of the three clients who claimed that they produced for export (the third may have been listed in error since she has no employees). One makes quilts and exports one-third, thanks to a sister in New Jersey who sells them.

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supported himself by working in the workshop in question. But he no longer worked there so his story remains hearsay.

<sup>3</sup>In previous research on ADEMI in 1985 and in more recent studies of microenterprises in Ecuador, Guatemala and Swaziland, ~~the author has found that in peak periods the owners of clothing/textile sector ventures often put out work to homeworkers with sewing machines. They are paid by the piece. The homeworkers may be ex-employees of the workshop, kin, or neighborhood women.~~

The second client exports his line of women's clothing sporadically and opportunistically, but this amounts to only some five percent of sales. (The man was described as a "marketing genius" by his loan officer, who said that his skill in selling is the secret to his venture's success.) As it happened, a third owner among the 11 claimed that he was an "indirect exporter," since he sold certain goods to a client who exported them to Curacao. A couple more owners mentioned that they would like to export in the future but would need much more help and information to do so.

To recap, the main connections uncovered between the microentrepreneurs and the export sector was via the movement of ex-free zone operators into informal sector workshops. This macro-micro link was viewed positively by the owners and, especially, the zona franca veterans, all of whom claimed to earn more working for the ADEMI clients - whose productivity they apparently enhanced.

### III. LINKS BETWEEN MACRO LEVEL TARIFF POLICIES AND MICROENTERPRISE

At this point in time, the Dominican Republic is at an awkward stage of the policy reform process. The tariffs have been cut on many finished goods, including clothing/textiles, while remaining quite high on the raw materials needed to produce these same items domestically. In the case of the clothing/textile sector, we were told by the majority of owners, this means that the imported cloth, thread and notions (merceria) are so expensive that even the most efficient small producer cannot match the price of imported goods.

The seriousness of this problem varied according to the type of merchandise produced by the microentrepreneur. In several cases, the threat of foreign competition was minimal because the workshop produced something which was not (yet) being imported to any great extent. This was true of the bedspread, quilt and sheet producers. In other cases, the competition was potentially lethal: this was true for all producers of men's, women's and children's clothes not in a special market niche - or lacking the "marketing genius" of the only producer of standard women's clothes who was not worried that such competition could put him out of business.

The use of specialized niches to reduce the impact of competition was a combination of accident and design. One woman began to produce more large size women's clothing after noticing that the imports were mostly in smaller sizes. Another ADEMI client made the deliberate and well-researched decision to produce baby clothes in the least often imported sizes and type: infants' (0-12 months) special occasion outfits. A third had stumbled onto producing uniforms for larger-scale firms. Thanks to his own work experience in the free zones, he said, he was so accurate that he could sell the uniforms without any fittings after taking the initial measurements; this comparative advantage was a big reason his otherwise nondescript neighborhood tailoring shop was growing. A fourth woman also had stumbled onto a low-competition mix of

sheets, mosquito netting and specialty item children's clothes.

There were variations in the source of the most damaging competition for those without a protected or semi-protected niche. First, five of the 11 microenterprises faced fierce competition from contraband. Three types of contraband were mentioned: goods smuggled out from the free zones, goods smuggled in from other countries, and goods that were snuck in over and above the amount declared on an import invoice.

In three of the five, owners mentioned illicit contraband from the zonas francas. This ranged from a little illegal moonlighting by supervisors to apparently large-scale dumping by some of the free zone firms, they alleged. The owners of one firm told of seeing a large truck from a free zone company unloading what they assumed was contraband to one of their larger customers in broad daylight. But without independent confirmation, it is not possible to conclude anything about the extent to which free zone merchandise leaks into the local economy, in competition with the goods produced by microentrepreneurs. Concerning classic smuggling, several owners cited the flow of contraband from Haiti and two claimed that much came from Panama. The third form of contraband the owners complained about was that which entered via phony declarations and a little help from cooperating customs officials ("they bring in 3,000 but they declare only 1,000").

A total of nine clients talked about the unfairness of having to compete with finished goods that came in with such low tariffs that they could undercut domestic production. All but two or three of the owners making this complaint seemed to understand that their disadvantage was compounded by their use of imported raw materials that was taxed at a higher rate. The others either claimed that almost all their raw materials were locally produced or had never thought about differential tariffs on inputs vs. finished goods.

Several made dire predictions about how this foreign competition would wipe out many microentrepreneurs (although, hopefully, not themselves) if the government didn't eliminate the unfair advantage of the finished goods importers. Loan officers agree that some clothing/textile subsectors are in mortal peril under the present discrepant tariff policies.

Nevertheless, there was cynicism about the likelihood of the government alleviating the plight of the small producers ("nosotros, los pequenos") via tariff reform on raw materials. The feeling was that the present arrangements advantage the richer and more powerful, so that change was not very likely.<sup>4</sup>

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<sup>4</sup> A final macro-micro link merits mentioning: the lack of reliable electricity, which was mentioned by three owners as their worst problem. Here, too, the government was viewed as responsible.

#### IV. CONCLUSIONS: CHARACTERISTICS OF THOSE MICROENTERPRISES BENEFITTING FROM MACRO LEVEL LINKAGES

In this final section, we first compare the size and growth pattern of the 25 firms which employed ex-zona franca operators with the 156 microenterprises which did not. Then we look again at those firms with niches or skills which shield them from the fiercest competition from contraband and legal imports, examining in more detail the strategy of one quite successful firm. This permits a preliminary conclusion about how to promote the economic condition of ventures - and people - in a situation where linkages with the macro levels of the economy are not always positive.

Size and growth of clients with and without ex-zone workers. Both ADEMI managers and asesores interviewed felt that it would be the somewhat larger and more dynamic confeccion clients who would be most likely to employ free zone veterans or have sub-contracts with zone firms and/or production for export. Since there were so few cases of sub-contracts or export production, it seemed best to compare the 25 ventures employing ex-zone operators with the remaining 156 clients in the sample. Once again, the reader is cautioned that these 181 questionnaires represent a non-random sample of the 1,312 ADEMI confeccion clients. Different asesores seemed to use different criteria to decide which clients to include, but the general rule apparently was to focus more on the larger producers.

Even keeping these caveats in mind, there is a very clear pattern: the 25 firms with ex-zone operators are considerably larger than the remaining 156, when compared by number of current employees. The 25 employ 178 workers, an average of 7.12 employees each. In contrast, the 156 employ 487 people, for an average of 3.12. In short, the 25 employ more than twice as many workers.

They also have had more employment growth than the 156 since receiving their first ADEMI loan: the 25 reported the creation of 64 new jobs since becoming ADEMI clients, for an average increase of 2.56 workers per firm. In comparison, the 156 were credited with creating 143 jobs, for an average increase of only .92 workers per firm. So the 25 have created more than 250 percent more jobs.

The job numbers serve as proxies for increases in fixed assets and monthly net income, since a partial analysis of all these variables in a sub-sample of the questionnaires revealed that they co-vary fairly closely. In other words, confeccion clients employing former free zone workers are growing faster than clients without such workers. They also were bigger to start with. At the time they received their first loan from ADEMI, they employed an

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average of 4.12 people, vs. an average of only 2.2 workers for the 156 when they first became ADEMI clients (see Table 2).

**Table 2: Clients Employing vs. Not Employing Ex-Free Zone Workers**

	<u>Ex-free zone workers (N=25)</u>	<u>No ex-free zone workers (N=156)</u>
<u>Mean Employees:</u>		
<u>Now</u>	7.12	3.12
<u>At first loan</u>	4.56	2.20
<u>Mean Job Creation:</u>	2.56	0.92

A fascinating topic for future inquiry is the extent to which the faster job generation and business growth of the ADEMI clients employing former zona franca operators has been sparked by the contributions of these apparently high-productivity workers. This may well be a "win-win" scenario for both owners and employees, whereby both achieve higher earnings from their mutual association.

Survival strategies of clients weathering the competitive storm. As noted, whether by accident or design, a common trait was found among those of the 11 clients who were best surviving the onslaught of three types of macro level import competition (low-tariff imports of finished goods, goods smuggled from other countries, and goods smuggled from the zonas francas). This was acquiring some form of comparative advantage, most often from a niche in the market that did not suffer high levels of import competition. Such niches included bedspreads, sheets and/or quilts; specialty types of children's clothes; and/or special sizes. But two other clients were helped by special skills: one man survived in the quite threatened women's clothes subsector through his exceptional talent in marketing, and another chanced upon a type of production (custom-made uniforms for workers in larger firms) that best used the skills he had learned as a zona franca operator - speed and accuracy.

One client's "five advantages": a vignette. One firm stood out for its complex and clever survival strategies: the one producing infants' (0-12 months) dressy outfits using cotton jersey woven on its own machines. Two of the three owners (the wife and sister of the man who is the "official" ADEMI client) were interviewed for about two hours, the longest single session in this brief rapid appraisal research.

They had grown greatly in the 39 months they had been ADEMI clients, rising from 11 to 24 employees. They had had four loans, rising from D.R. \$20,000 to \$102,040 (the most recent at D.R. \$12.50 = U.S. \$1.00). Their fixed assets had risen from D.R. \$941,360 to \$1,570,710, while their monthly sales had increased from D.R. \$64,000 to \$160,000. Meanwhile, their net profits per month (beneficio neto por mes) had gone up from R.D. \$26,294 to \$47,774.

Their five advantages, as seen by the two owners:

1. The 0-12 sizes comprise a niche with less competition;
2. They keep coming up with especially innovative designs;
3. They make their own jersey-type cloth;
4. The male owner was trained in textile technology in New York, in all operations from pattern making to machine maintenance - so they never have to hire expensive U.S. mechanics to fix a broken machine;
5. They pay lower wages than in the formal sector.

This was the only firm where the owners claimed that free zone workers earned more than in their plant. While it was not possible to get wage information on all the 11 clients, it should be noted that their workshop did not look like a sweatshop. The plant was not only the largest and most modern one visited, but it also was very well lit and adequately ventilated. It also was the only plant physically located next to two free zones. Therefore, the owners complained that they trained workers who then left them for the zones, since a fast, accurate worker could earn more there. Clearly, more work is needed to resolve the contradiction on worker earnings that emerged with this client. But they themselves rated the fact that their wage bill was lower than it would be in the formal sector as the least of their advantages.

The main policy implication of these findings is that survival is possible for both clients and workers beset by macro level import competition. For ADEMI confeccion clients, the best remedy seems to be: (1) hiring well-trained and productive ex-zona franca operators who prefer the earnings, location, and working conditions of the microenterprises - and can help both co-workers and owners raise productivity, and (2) finding a niche or other comparative advantage, with the help of ADEMI and/or other donors.

The stakes are high. ADEMI's confeccion clients are 56 percent women, and there is a substantial female majority among workers. ~~The workers are quite poor and the clients (initially) not that well off themselves.~~ So helping these groups survive and thrive in a changing macro level economy could help both development and equity goals.

