

Employment and Small Scale Enterprise Strategy Paper

004201

Introduction

This paper presents the USAID's preliminary strategy to achieve its program goal of expanding employment opportunities in Bangladesh through facilitating the emergence of small scale, labor intensive, enterprises. The strategy refines the USAID's goal by expanding the target population to include both rural and non-rural employment. Expanding employment throughout Bangladesh, especially the smaller urban areas, is the USAID's refined program goal.

The paper similarly acknowledges that our strategy is inchoate; a number of issues have not yet been resolved. The most salient of these is how can USAID best maximize its impact given the finite resources available and the magnitude of the problem in a country where wide-spread poverty and persistent unemployment are endemic, land resources are limited and population pressures are intense. Further, however large the problem, any USAID activity must have sufficiently broad impact to justify the commitment of resources. Another issue is the relative emphasis we should assign to on-farm and off-farm employment programs in a still agrarian, although urbanizing country. Finally, we recognize the lacunae in our understanding of the unemployment problem, the lack of panaceas, and that solutions to the complex unemployment problem in Bangladesh, or elsewhere are not obvious.

We acknowledge that our strategy is only one part of a more expansive employment generating strategy that explicitly recognizes that: (1) the agricultural sector will long continue to be the largest sectoral

employer in Bangladesh; (2) reductions in human fertility will have a profound effect on employment issues (e.g., in the economic dependency ratio); and (3) that expanding demand (e.g., increasing agricultural productivity and rural incomes, tapping into export markets) is crucial if small enterprises are to expand.

The Problem

An extremely high rate of unemployment and underemployment, fueled by a high population growth rate and stagnant per capita agricultural productivity is one of the most critical problems confronting Bangladesh. The need to create productive employment opportunities is one of Bangladesh's most serious structural problems, now and well into the next century.

The unrelenting and increasing flow of new entrants into the labor force is dictated both by demographic and agricultural considerations. Despite recent strides in family planning acceptance, Bangladesh's population is expected to increase by over 40% by the end of the century. The labor force is expected to increase even more rapidly than the working age population during this period. IBRD projections of growth rates of the labor force for the five year periods leading to the year 2000 are as follows: 1985-90: 3.2%; 1990-1995: 3.4%; 1995-2000: 3.5%. These figures reflect not only demographic factors but also anticipated sharp increases in labor force participation rates by females caused by a number of factors, including government policies to raise the status of women, increased female student enrollment rates, increased acceptance of family planning, and increased landlessness and poverty. This points to the need to focus special attention on women's labor requirements. In addition, a

number of "escape valves," previously available especially to Bangladeshis with a modicum of technical skills looking for productive work, are disappearing. These include cross-border migration, and opportunities in the Middle East. The IBRD projections show an increase in the labor force of 21.2 million persons during the 1985-2000 period. Thus, stimulating the creation of new (net) productive jobs for these people promises to be a formidable task for which there is no easy response.

The first question to be addressed in a strategy statement on employment is "where:" in which sector or subsector should USAID/Dhaka concentrate its energies? As discussed in the FY 1986 CDSS, the USAID has adopted a multi-faceted strategy to address employment issues. Agriculture will continue to be the largest sectoral employer in Bangladesh. However, despite encouraging progress in increasing food grain production the past few years, with increased acreage under irrigation and use of HYVs, the agricultural sector will, at best, be able to absorb no more than 25% of the increased labor force. In order to protect the on-farm share of the workforce, and expand agriculture's potential to absorb at least part of the expanding labor force, we will address on-farm employment expansion by the diffusion of labor-intensive HYV technologies and agricultural research on relatively labor-intensive crops and farming methods. In addition to direct employment aspects, agricultural productivity is also critical to expanding off-farm employment, as increasing agricultural income stimulates domestic demand for goods and services. Agriculture also produces raw materials needed for processing industries.

. Construction and maintenance of rural infrastructure -- Food for Work and district roads, and bridges and culverts -- provide critical short-term, seasonal employment for a large number of rural poor. It also has a longer-term development and specifically employment impact through the creation of rural assets which facilitates the flow of goods and services. While activities designed to increase agricultural productivity and create rural infrastructure are important, because of the severity of the problem in Bangladesh, they are insufficient to adequately address the structural problems of unemployment. Other activities are warranted, provided that the returns are greater per unit of cost (in money and USAID/BDG manpower) than would be incremental investments in basic, broad-scale infrastructure projects and agriculture.

Other possible options to stimulate employment have been considered by USAID. Initial examination of these options leads us to the following, not immutable, conclusions. The expansion of public sector enterprises or of the government itself is neither useful nor likely. Formal sector manufacturing enterprises account for a very small share of total employment; even very rapid growth rates would enable this sector to absorb only a small share of the annual increases in the labor force. Cottage industries in general have an unpromising future, both in terms of overall growth and in terms of levels of labor productivity. We are left with small,* efficient, profitable enterprises, in both the industrial and the service sectors, that produce for both domestic and external markets.

*However, one can easily overemphasize the importance of smallness. The Asia Bureau strategy paper correctly cautions against emphasizing the issue of enterprise size. The issue of labor intensity clearly is more important.

The paucity of reliable information in Bangladesh is particularly evident in the employment/small enterprise field and affects AID's and the BDG's ability to think creatively about ways to address the employment problem. Even basic data on unemployment are widely considered unreliable. Reasonable estimates range from 23% agricultural unemployment (IBRD), 42% rural unemployment (Bangladesh Institute of Development Studies); the most recent Planning Commission estimate is about 30%. These results, all based on quick surveys, adequately document the magnitude of the unemployment problem. But the data base does not permit any analysis that might lead to proposed solutions.

The data base on small enterprises is similarly weak. Recent labor force surveys and general observations suggest that small enterprises comprise a dynamic subsector in which productive employment opportunities are being generated rapidly. However, there are no reliable comprehensive data on enterprises, particularly small enterprises, in Bangladesh. Existing evidence is too weak to support efforts to design defensible interventions that will have a broad impact. For programming purposes, steps to fill this gap in the data base are urgently and immediately required.

A host of other examples could be cited to underscore the need to generate data and to conduct studies on matters relating to employment and small enterprises in Bangladesh. For example, we know very little about labor markets and how they work, about the informal financial systems in which small enterprises typically operate, or about the social and cultural patterns that condition the behavior of people who operate small enterprises. The contrast with the agriculture and

population sectors. Two other areas of strategic concern to USAID/Dhaka, is striking. Agricultural and demographic censuses are conducted routinely. Massive data collection efforts support ongoing research and thoroughly inform our programming and project design efforts. Obviously, an adequate data base is equally important in the employment/small enterprise field.

Constraints Affecting Small Scale Enterprises

- Policies. Policies in Bangladesh are distorted against small enterprises. This is a consequence of BDG efforts to promote large, capital intensive, firms. For example, the licensing and sanctioning systems put in place to influence investment patterns have degenerated into control and allocation mechanisms. These mechanisms are readily accessible to large firms with good political connections. Small firms are more or less excluded. The BDG has compounded the problem by creating special programs to subsidize small firms. These programs put additional distortions in place; since only a few can benefit, many suffer.

Policies typically are distorted against labor use as well. Cheap capital (often provided by donors) is one of the most widely used forms of subsidy. Machinery and equipment usually are heavily subsidized. Other productive inputs (e.g., land, material inputs) sometimes receive subsidies. To the extent capital and these inputs substitute for labor, policies discriminate against more intensive labor use.

The first task, then is to rely more heavily on market allocation mechanisms "to get relative prices right." But these are not simple tasks. And, by themselves, they frequently are not enough. Some distortions, especially in labor and in financial markets, cannot be

easily corrected by governments. For example, in Bangladesh, labor markets are highly segmented and financial markets are underdeveloped. Simply getting prices right will not by itself overcome the distortions caused by deepseated institutional rigidities in labor markets or by poor intermediation in underdeveloped financial markets.

Credit. Donors, especially the multilateral agencies, have ensured that credit is generally available to enterprises and industries. However, donors have been less successful in making credit accessible to efficient, labor-intensive and innovative small firms. While donor credit has been easily disbursed through national development banks, loan repayment has become a major problem. This situation has caused considerable concern among the BDG and donors, and has made donors cautious in continuing or expanding these credit programs. Credit has frequently been used for capital-intensive technologies that subvert labor-generating objectives. Burdensome transaction procedures also compound inefficiency and all too frequently discourage the entrepreneur who is not politically connected.

Human Resources. While unskilled and semi-skilled labor abound and can be easily absorbed into new, low technology industries, (the burgeoning garment industry is a good example), there is a relative dearth of entrepreneurial and managerial skills. Inadequate access to quality education in management, business administration and economics acts as a constraint to effective analysis and implementation of policies that effect small enterprises, as well as to the competent management of small firms. Inadequate access to decent basic education hinders the expansion of a minimally educated workforce.

Infrastructure. Basic physical infrastructure, in rural areas, is

inadequate to support the emergence of new enterprises. This is especially true in towns serving rural markets that must depend on a reliable supply of power as well as on a transportation system to assure the supply of raw materials and facilitate the flow of goods and services. Inadequate rural infrastructure similarly limits agricultural productivity, and hence incomes, needed to purchase these goods and services. Most secondary roads in Bangladesh cannot be used throughout the year, and only about 10% of the population has access to electricity. The building of additional basic infrastructure is critical to stimulating productive employment, both in and off the farm.

The Strategy

USAID's strategy seeks to address these key constraints to the growth of small enterprises. We acknowledge that the strategy is still in its formative stage, and we will be instructed by the additional data, study results, and project level experience that we will gain in the next few years. USAID further recognizes that, while our commitment to employment in general and more specifically, small enterprise development is major and long-term, we alone cannot solve the unemployment problem. In order to maximize the impact of our limited resources, our efforts must have a catalytic effect on both the government and other donors by focusing attention and resources on the problem and on potential solutions. Similarly, our efforts must have a catalytic effect on the indigenous private sector; all donor efforts combined can produce fewer jobs than local entrepreneurs investing local resources.

USAID will adopt an indirect approach to promoting the expansion of small scale enterprises by helping: (1) to create the policy

environment in which these enterprises can flourish; (2) to create a reliable physical infrastructure that can stimulate economic growth, incomes and employment; and (3) to build the capacity of public and private institutions to increase the pool of skilled entrepreneurs, managers and administrators. In addition, USAID will adopt a direct approach to promoting specific labor-intensive enterprises that introduce either innovative technologies or new non-traditional exports. Although we cannot ignore the phenomenal growth of Dhaka and the need to create jobs in the metropolitan area, we will concentrate our efforts in smaller towns classified in the 1981 demographic census as urban areas and identified by the government as "growth poles."

Indirect Interventions

Data Collection and Policy Formulation

With a one million annual increase in the labor force requiring massive amounts of new productive off-farm employment opportunities, the magnitude of the unemployment problem, in the aggregate, is commonly understood. The BDG, in its forthcoming Third Five-Year Plan, will place as its highest priority the need to generate new employment. Yet as we discussed above, very little is known about off-farm employment in Bangladesh. An obvious first step for any long-term commitment to encourage off-farm, especially small, labor-intensive enterprises, is to find out more about them.

USAID intends to strengthen the capacity of the BDG to formulate national policies to stimulate the emergence of small-scale enterprises in two ways. First, we will support the collection of data, through a national economic/enterprise census with the Bangladesh Bureau of Statistics (BBS). The BBS economic census will

cover all non-agricultural economic activities in the country (including mining, construction, trade, services, transport, storage, communication and cottage as well as manufacturing industries). We intend to contract the services of the U.S. Bureau of the Census, (BUCEN) to assist BBS in performing the census. BUCEN has been working with BBS for a number of years, funded by UNDP. As we mentioned in last year's CDSS, the EDG is committed in principle to performing the census. We believe that, by providing technical and capital assistance the census, data can be published earlier and have a greater magnitude of reliability.

The economic/enterprise census will be supplemented by a series of surveys to explore issues such as the changes in employment patterns that may occur over time. The survey program will collect information from the census universe. An annual economic survey would collect data on value of output, value of raw material and other inputs, fixed assets formation and the like. Special survey topics might include: a household and cottage survey to explore trends over time; the incidence of backward linkages in specific industries; and a survey of the small scale construction industry.

Second, USAID will collaborate with the Planning Commission to conduct studies and make specific recommendations on policies that will facilitate the expansion of small enterprises. Without prejudicing the precise identification of policy studies to be explored, certain policy areas suggest themselves. For example, small-scale enterprises seldom make use of formal sector financial institutions. Informal financial systems, including those based on the much denigrated rural moneylender and his urban counterpart, must be more closely examined. The links connecting the informal financial systems and small

enterprises must be better understood, as well as how formal financial markets can serve these enterprises. Similarly, we need to understand the legal context that governs the behavior of small enterprises and the informal but binding agreements and other business practices that characterize small enterprise activities. The extent, nature and potential of subcontracting systems as a means of promoting small enterprises also will be studied. The Planning Commission will pay special attention to the likely differential impact of their policy recommendations on different socio-economic groups, including women, whose participation in the workforce is expected to double by the end of the century.

The census and studies projects should improve the capability of the BBS and the Planning Commission to analyze data as well as formulate and evaluate policy recommendations. AID is very supportive of the direction the Planning Commission is heading in asserting a role in policy formulation in general, and specifically in employment generation. The Planning Commission has assigned highest priority to study and better understand the causes and ramifications of the unemployment problem, as well as to recommend policies that encourage the growth of productive employment. It is increasingly engaged in policy-planning rather than in allocating public sector investments. The technical assistance we provide the Planning Commission will further encourage this trend.

The census, surveys and studies to be performed in the next 2-3 years will provide us and the BDG with a better grasp of the myriad of constraints affecting small enterprises, as well as a more rational basis upon which to design programs and projects to address the

PROJECT PROBLEMS.

Non-Project Assistance

By the beginning of FY 1987, USAID will have identified a number of factors in the economy which inhibit the viability and growth of small enterprises, as well as further define the relationship between these enterprises and employment. The census, surveys and studies should lead to a refinement of our strategy and influence program directions. AID and the BDG will have better knowledge about the kinds of reforms that would facilitate SSE growth and profitability.

A policy dialogue initiated by USAID and informed by the studies, as well as the results and recommendations of the IBRD Trade and Industrial Policy project, may lead to a policy-oriented intervention, which will provide TA, training and general revenue support to elicit policy changes that have a positive impact on small enterprises.

The Rural Finance Project has played a role in encouraging reforms, especially increased interest rates, in the banking system. There seems to be emerging a greater reliance on savings in lieu of refinance as a source of bank funds. Nonetheless, a great deal there is still to be accomplished if the banking system is to perform its financial intermediary functions effectively, free from excessive and arbitrary government directives that allocate credit or control interest rates.

If we find from the studies and pilot interventions that formal sector financial institutions can be made to serve the capital needs of small enterprises in the industrial and service sectors, and that policy and administrative reforms in the sector offer substantial prospects to service these needs, USAID will consider a follow-on to the Rural Finance project. In addition to the formulation of effective credit

possibilities, the project might provide working and fixed capital to small enterprises in urban and rural areas, or provide other productive assets through a CIP.

Training

USAID will greatly expand and more sharply focus its training activities to provide quality in-country and U.S. education in public administration, management, business administration and economics. We expect that the impact of this expanded training effort on the expansion of small-scale enterprise will be both indirect and direct. Any effort we make in engaging the government in a policy dialogue to make informed policy decisions affecting employment and small enterprises will be seriously impaired if our counterparts lack suitable conceptual skills. Our attempts to improve the effectiveness of financial institutions will similarly be wasted without trained managers functioning in those institutions. The small private enterprises that are the target of our assistance efforts require effective managers. The growth and productivity of enterprises require competent entrepreneurs.

USAID has had some success in providing management training through specialized courses to women who have established small enterprises. While this activity will continue, its impact will be limited unless we strengthen local management and public administration training institutions' capability to provide basic management and business skills.

Rural Infrastructure

Labor intensive construction and maintenance of rural infrastructure provides greatly needed seasonal employment for the landless or near-

landless rural poor, while it creates a basis for longer-term productive employment opportunities.

USAID's rural public works program has an immediate employment impact. The program -- Food for Work administered by CARE -- employs seasonal labor, reaching approximately 830,000 workers per year providing over 25 million person/days of employment annually. One recent study of FFW roads (Abt Assoc.) concluded that the roads do have a significant positive impact on local communications, increased use of new farm technology, increased access to social services, and increased commercial activity. The Zilla Roads Maintenance and Improvement project similarly employs labor-intensive techniques. The residual immediate employment affect of these activities -- the labor employed in meeting demand for construction materials, bricks, steel rods and sand -- is important, but difficult to measure.

Although it is still premature to evaluate the impact of our Rural Electrification project, quick studies and observation suggest a significant, immediate increase in economic activity when rural areas gain access to service. Sixty percent of power provided in our project account is being consumed by rural industries and 9% by commercial enterprises. The USAID and the Rural Electrification Board (REB) have been encouraging productive uses of power by assigning priority to agricultural, industrial and commercial users. According to a REB study, thus far under our Rural Electrification I & II projects, over 18,000 commercial connections have been made, each employing an average of four people. Over 2000 small industrial units have gained access to electricity, employing an average of 5 workers as have 237 large industrial enterprises, each employing over 150 workers. While the direct impact of electricity on productivity and

employment has been observed and partially documented. USAID will conduct an evaluation of Rural Electrification to more precisely assess labor-generating impact, especially on unskilled and semi-skilled workers. Conventional wisdom suggests that basic rural infrastructure - electricity, and roads - provides a critical stimulus to economic activity, increasing incomes, demand for goods and services, and consequently employment. We intend to examine the employment effects of our infrastructure activities during the course of the year.

Similarly, any success in our rural electrification activity is not simply a factor of building the necessary infrastructure. Sustained generation of energy to the rural area depends ultimately on the ability of cooperatives to achieve financial viability by eliminating price subsidies, increasing density of service and improving their management capability. These will be the foci of our continued efforts in rural electrification.

Building unpaved feeder roads through the FFW program linking formerly isolated areas with the Zila road (district) system provides substantial short-term employment. But long-term affect on sustained economic activity and hence on more permanent employment opportunities requires that these assets be maintained and a useable transportation system developed. In the Zila Roads Maintenance and Improvement project, we have begun to try to institutionalize a routine road maintenance program at the district level. We recognize that in Bangladesh, as elsewhere in the developing world, governments perceive little tangible benefit from, and thus provide little financial support to simple, routine infrastructure maintenance activities. The

value of asset maintenance is admittedly difficult to inculcate, but we have recently noted some signs of progress, at least in terms of an attitudinal change. We intend to persist in our district road pilot maintenance activity, with the objective of institutionalizing a maintenance capability, as well as continue our efforts to get the BDG to take a serious look at the issue of funding for maintenance through the generation and allocation of local revenue. Although success is in no way assured, given the critical importance of maintenance and the possibility that successful road maintenance might have a spill-over effect on other infrastructure, we believe it is worth the effort.

Direct Interventions

Credit. While USAID, the BDG and other donors gather the data and perform the studies that will give us a better grasp of the dynamics and nature of the non-agricultural labor force, we will continue or begin relatively small interventions that appear to hold promise as ways to enhance small enterprises, financial markets, and subcontracting relationships.

As we mentioned above, USAID should introduce innovative ways to address the employment problem. When host country policies do not act as a serious constraint, and for example, new exports in which Bangladesh has a comparative advantage can be identified, then, as the garments export industry illustrates, labor-intensive enterprises can indeed expand. In the case of the garments export industry, suitable institutions were established (bonded warehouses and back-to-back letters of credit) which minimized the risk to the local entrepreneur. We believe other industries can also "take off." These include the assembly of electronic components for export, and contract-farming to

supply seafood and fish for export-oriented processing. One of the constraints, however, is access to capital by "risk-takers" or innovators. The primary problem is to get the initial investors to act, or the initial production facilities built, or initial export sales made.

In FY 1981, USAID initiated a pilot project with an NGO, MIDAS (the Macro-Industries Development Assistance Society), to extend technical assistance and credit to small enterprises. In 1983 MIDAS redefined its emphasis to focus on investments in those small enterprises that could make significant contributions to off-farm employment by producing non-traditional exports, introducing new technologies, or forming joint ventures with foreign firms.

MIDAS has demonstrated its effectiveness as a credit and technical assistance mechanism. It currently makes 15 to 20 loans annually, refers additional loan applications to other donor and commercial lenders, and carries out a variety of consulting tasks. MIDAS has also achieved excellent loan payment performance.

However, MIDAS still tends to rely on "targets of opportunity" and has yet to fulfill its mandate to identify innovative, labor-intensive industries with good prospects for expansion, as well as provide a credit outlet to entrepreneurs willing to take risks. Now established as an effective organization, MIDAS must direct its efforts at reaching beyond a role as a traditional credit and T.A. vehicle.

We plan to continue and/or expand our support to MIDAS if we see evidence that it will do so. Several possibilities are currently being explored prior to any significant new obligation of funds. One is to strengthen core MIDAS management and help it establish two

specialized divisions. A business Innovation Division might identify new (to Bangladesh) product lines, production technologies, marketing strategies, business methods, or other innovations which can be usefully adopted by small enterprises in Bangladesh. Division employees will then aggressively seek out entrepreneurs willing to adopt these innovations, and assist them in preparing applications for processing under normal MIDAS procedures. A Subcontracting Division could identify opportunities for establishing stable, commercially-viable relationships between medium-scale "parent" firms and small-scale subcontracting firms in the private sector. Technical assistance and credit (at commercial rates) will be used to encourage and nurture stable subcontracting arrangements.

USAID is beginning a small pilot activity with BSCIC to explore the constraints and opportunities which may exist in sub-contracting in Bangladesh, as well as test whether formal banking institutions can serve the financial needs of small enterprises that produce for parent firms.

Lessons learned from our on-going direct interventions and pilots, as well as from the studies, will form the basis for a Small Enterprise Assessment to be performed in FY 87.

Conclusion

Assuming a long-term commitment to helping resolve the problem of unemployment, the most salient issue AID must address in the formulation of an employment/small enterprise strategy in Bangladesh is how we can maximize our impact given both the magnitude of the problem and anticipated levels of funding. A top priority is to get a better grasp of the nature of the unemployment problem and of the options available to the USAID to encourage expansion of labor-

intensive small enterprises. We have presented here a few tentative choices, but it is essentially a plan on how we intend to proceed in developing a strategy. The economic census, surveys and TA/studies are logical preliminary activities. To the extent that our policy studies proposal identifies policies that act as constraints to the emergence of a vital small enterprise sector, and the government is receptive to making policy changes, then non-project assistance and/or a credit program that reaches the small entrepreneur who currently has access to credit only through informal mechanisms, is warranted. We will also examine the potential for such specific production arrangements as sub-contracting to further promote the development of small enterprises.

Certain interventions are being considered because they either show promise to have an impact beyond the limited resources we can commit, or because investments in human resources and physical infrastructure provide a basis for longer-term employment opportunities. The MIDAS project, with its limited direct impact, must demonstrate its capability to act as a facilitator of innovation.

The unemployment problem does not permit an early or easy solution. Nor can we presume to resolve the problem. What we can reasonably hope to achieve, however, is to help create and sustain a policy and institutional environment in which small enterprises can flourish, to identify new ways to promote the creation of enterprises, and have a catalytic effect on government and other donors to focus attention on the problem.